Petition

No. 81-1160

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IN THE

Supreme Court of the United States

CLYDE L. STROUP,

Petitioner,

vs.

FRANCIS C. TUCKER, AND
CHARLES R. CHADBOURN,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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QUESTIONS PRESENTED

1. Whether the rulings of the lower Courts, concerning conspiratorial responsibility in a Securities fraud case, is contrary to the law established, and departs from the requisite intent requirements in Rule 10(b)-5 cases.

2. Whether the Petitioner could effectively withdraw from any alleged conspiracy to defraud investors, by resignation from the business entity and withdrawal from any further participation in the continuing investment activities.

3. Whether the Petitioner could be held liable to the Respondents as an aider or abettor in a Securities fraud case without the Respondents' first showing the elements of *scienter* or reckless disregard.

4. Whether the Petitioner's effective resignation and lack of further participation in the investment scheme constituted some affirmative action to disavow or defeat the purpose of the conspiracy.

5. Whether the holding of a former participant, who had ended his association with an investment scheme long before alleged fraudulent activities had occurred, as an aider or abettor in furtherance of such fraudulent scheme, would be too novel a construction already sufficiently extended by application of the Securities laws.

6. Whether the Respondent, CHADBOURN, had the burden of establishing with reasonable certainty his damages from a cause for which the Petitioner may be liable, and whether the issue of damages could have been submitted to the jury since the threshhold burden of presenting "some evidence" had not been met.

7. Whether the Appellate Court's interpretation of the Federal Rules of Evidence, Rule 801 (d)(2) is contrary to the mandates of this Court and overlooks the foundational requirements for the admission of conspiratorial evidence.

PARTIES TO THE PROCEEDINGS

The caption of the case in this Court contains the names of all parties.

Originally there were 26 Plaintiffs and 31 Defendants. Prior to trial, various Defendants were dismissed and certain Plaintiffs reached settlements with Defendants, CORNELIUS PITT, ROBERT V. MUELLER, UNITED OF AMERICA BANK, and MICHIGAN AVENUE BANK. Defendant, LAWRENCE JANOTA, defaulted. A few weeks after judgments were entered on the verdicts in favor of Plaintiffs, TUCKER and CHADBOURN, a default judgment order was entered against Defendants, JANOTA, FINANCIAL PROFILES, INC., PROFILES CORPORATION, WHEELING II LIMITED PARTNERSHIP, WHEELING CONDOMINIUM TRUST I, and WHEELING CONDOMINIUM TRUST II in the amount of $2,049,295.06 plus interest. The record does not disclose what was done as to the remaining Defendants at the meeting scheduled for September 28, 1980, before Judge Decker, District Court Judge.

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CHARLES R. CHADBOURN,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

To the Honorable Chief Justice and Associate Justices of the United States:

Petitioner, CLYDE L. STROUP, petitions this court for the issuance of a Writ of Certiorari to the United States Court of Appeals for the 7th Circuit to review its judgment of August 25, 1981, affirming the judgment of the District Court of the United

States for the Northern District of Illinois, Eastern Division, to the end that its judgment be reversed with directions to reverse the judgment of the court below.

OPINIONS BELOW

The opinion in the instant appeal appears in Appendix A attached hereto. The opinion on appeal was not reported pursuant to Circuit Court Rule 35 (U. S. Court of Appeals, 7th Cir., Rule 35) and remains unpublished, not to be cited.

JURISDICTION INVOKED

The jurisdiction of this Court is invoked under Section 1254 of the Judiciary Act (28 U.S.C., Section 1254). The judgment was entered August 25, 1981 (See Appendix A).

A Petition for rehearing en banc was filed September 8, 1981, (See Appendix B), and such Petition for Rehearing was denied September 23, 1981 (See Appendix C).

The time to file the Petition was extended here to December 23, 1981, pursuant to Rule 20.4 of the Supreme Court Rules.

STATEMENT OF THE CASE

This action was originally filed in the United States District Court for the Northern District of Illinois, Eastern Division. The action arose under the Securities Act of 1933, 15 U. S. C., Section 77(a), et seq., the Securities Exchange Act of 1934, 15 U. S. C., 78(a), et seq., and jurisdiction was invoked pursuant to 28 U. S. C. Section 1331, 1337 (Section 22 of the Securities Act of 1933, 15 U. S. C. Section 77(v), Section 27 of the Securities Exchange Act of 1934, 15 U. S. C., Section 78(aa).

In the original action, there were 26 Plaintiffs and 31 Defendants. Prior to trial, various Defendants were dismissed and certain Plaintiffs reached settlement with certain other Defendants. At the time of trial, only the Petitioner herein, CLYDE L. STROUP, remained as the sole Defendant. The two (2) Plaintiffs that remained in the litigation were Dr. CHARLES R. CHADBOURN, and Dr. FRANCIS C. TUCKER, both practicing Illinois physicians. LAWRENCE JANOTA defaulted and a few weeks after, judgments were entered on verdicts in favor of Plaintiffs TUCKER and CHADBOURN, a default order was entered against Defendants JANOTA, FINANCIAL PROFILES, INC., PROFILES CORPORATION, WHEELING II LIMITED PARTNERSHIP, WHEELING CONDOMINIUM TRUST I, and WHEELING CONDOMINIUM TRUST II in the amount of $2,049,295.06 plus interest.

According to the Amended Complaint, Defendant, FINANCIAL PROFILES, INC., was an Illinois corporation doing business there and solicited sales of "tax shelters" from Plaintiffs in projects that were unsuccessful. In early 1971, the Defendants in the case, JANOTA and STROUP, formed an Illinois corporation known as FINANCIAL PROFILES, INC. and each owned or agreed to own Fifty Percent (50%) of the outstanding shares of stock in the corporation. STROUP was an officer in FINANCIAL PROFILES and was also a partici-

pant in a Trust known as Gallery Investment Trust. STROUP owned Twenty-Five Percent (25%) interest in the Trust. At the same time, STROUP formed FINANCIAL PROFILES, INC. another business organization was formed called Gallery Limited Partnership in which STROUP held a Twelve and One-Half Percent (12½%) limited partnership interest. Several other individuals were highly active in the formation of these business organizations and conducted the business of such organizations during the formative stages of their existence.

In 1971, FINANCIAL PROFILES sold to Dr. TUCKER, an interest in the limited partnership known as Gallery Limited Partnership for the sum of Thirty Thousand ($30,000.00) Dollars and also sold to Dr. CHADBOURN an interest in Gallery Limited Partnership for the sum of Ten Thousand ($10,000.00) Dollars. The purpose of the partnership was to own and operate a parcel of real estate located in Chicago, Illinois. The limited partnership was to receive income from the leasing of the premises.

Gallery Investment Trust had previously purchased the property in Chicago, Illinois for the sum of One Million Forty Thousand ($1,040,000.00) Dollars and a Twelve and One-Half (12½%) Percent interest in the limited partnership. Gallery Limited Partnership purchased the subject real estate for One Million Four Hundred Fifty Thousand ($1,450,000.00) Dollars and accepted from the limited partnership a Note and Mortgage for a portion of the purchase price. The Trustees of Gallery Investment Trust were STROUP and two (2) other Defendants, but STROUP received no proceeds from any purchase made of the real estate in question.

Gallery Investment Trust pledged to the limited partnership its interest in the partnership to insure faithful performance of all of the undertakings of the General Partner. In 1971, Dr. STROUP tendered to FINANCIAL PROFILES, INC. his resignation as an officer and director of the corporation and the

resignations were immediately accepted by the corporation. From the date of the resignations, Dr. STROUP had no further involvement of any kind or any nature whatsoever with the corporation and was, in fact, locked out of the premises and had no access either to the premises or any of the corporate records.

In April of 1972, STROUP disposed of all his interests in FINANCIAL PROFILES, INC. and thereupon terminated any equity ownership or involvement in the Gallery Limited Partnership.

FINANCIAL PROFILES and its principal officers were alleged to have falsely and fraudulently represented to CHADBOURN and TUCKER that they would receive a guaranteed minimum return on their investment, that the investments were economically sound, and that all their invested capital would be returned to them. The alleged fraudulent scheme that the Plaintiff alleged comprised the sale of limited partnership interests in 21 or more real estate projects sold to each of the Plaintiffs, who paid for them through purported loans. All of these sales occurred after April of 1972 and after STROUP had terminated his relationship with FINANCIAL PROFILES, INC. and Gallery Investment Limited Partnership. Prior to April of 1972, STROUP allegedly failed to disclose to CHADBOURN and TUCKER various material facts about the investments, including many of the risks, the financial condition of the investment opportunities, and the identity of the principals involved in the investments. STROUP met with TUCKER only once and that was in the Summer of 1971 and there was nothing in conversation between the two (2) parties either directly or indirectly about the merits of the investments. STROUP had never met with CHADBOURN. It was alleged that all the Defendants had failed to disclose to TUCKER and CHADBOURN various material facts about the investments, including many of the risks, the financial condition of the investment opportunities,

and the identity of the principals. STROUP was alleged to have failed to disclose these material facts even after his resignation in 1972 when he had no further contact with the business organizations. The business at that time had been carried out by the other Defendants involved in this litigation.

Defendants were charged with having entered into deceptive and manipulative courses of conduct in connection with the offering for sale of the securities, but the only securities which STROUP had any connection with were those involving Gallery Limited Partnership and no others. The foregoing conduct of the Defendants was said to violate Section 10(b) of the Act because each of the Defendants employed devices to defraud Plaintiffs in connection with the sale of partnership interests and beneficial interests in all 21 partnership and condominium trusts and convertible preferred stock in the Defendant, NATIONAL AMERICAN CORPORATION; and in arranging purported loans for the Plaintiff with Michigan Avenue National Bank and United of America Bank, both of Chicago. All of the Defendants including STROUP are said to have violated Rule 10(b)-5 by making false statements which induced CHADBOURN and TUCKER to purchase their securities and obtain loans and sell certificates of indebtedness to Banks.

All the Defendants' activities were described as a scheme or conspiracy and a deceptive and manipulative course of conduct operating as a fraud and deceit upon CHADBOURN and TUCKER, in violation of Section 10(b) and Rule 10(b)-5. This vague and undefined activity of Defendants other than STROUP focused on affirmative acts after the time STROUP had withdrawn from his association with the alleged scheme or conspiracy. STROUP's only culpability was alleged to arise out of his omission to act to defeat the alleged original object of the conspiracy. Nowhere in the record is there any evidence to show STROUP's affirmative acts to deceive or defraud either CHADBOURN or TUCKER.

The Amended Complaint also relied on other provisions of the Federal Securities laws, the Illinois Securities Act, and the Defendants' common law breach of fiduciary duty as investment advisors to CHADBOURN and TUCKER. However, at the close of the evidence, CHADBOURN and TUCKER advised the District Court that they would go to the jury solely as to violations as to Rule 10(b)-5, and, therefore, instructions given by the Court were tailored to a 10(b)-5 case.

On July 1, 1980, the verdict of the jury was entered in favor of the Plaintiff, Dr. TUCKER, and against the Defendant, CLYDE L. STROUP, and damages were assessed in the amount of One Hundred Fifteen Thousand ($115,000.00) Dollars. In addition, judgment was entered in favor of the Plaintiff, Dr. CHARLES CHADBOURN, and against the Defendant, CLYDE L. STROUP, and damages were assessed in the amount of Thirty-Five Thousand ($35,000.00) Dollars. Dr. CHADBOURN failed to appear and testify at the trial. A motion to set aside the verdict and enter judgment for Defendant STROUP was made and denied. The Defendant thereafter appealed to the United States Court of Appeals for the Seventh Circuit.

The appeal was docketed on August 25, 1980, and the case was argued before the Appellate Court on May 13, 1981. On August 25, 1981, the Appellate Court affirmed the judgment of the District Court and found as a matter of law, the evidence supported the jury verdict, that the award of damages for both Dr. CHADBOURN and Dr. TUCKER were supported by the evidence, that it was unnecessary to submit a special verdict to the jury and that STROUP's evidentiary objections were not well taken relating to hearsay evidence taken pursuant to Rule 801(d)(2).

It is from the decision of the United States Court of Appeals for the Seventh Circuit that the Petitioner respectfully requests this Court for the issuance of a writ of certiorari to the

United States Court of Appeals for the Seventh Circuit to review its judgment of August 25, 1981 affirming the judgment of the District Court of the United States for the Northern District of Illinois, Eastern Division, to the end that its judgment be reversed with directions to reverse the judgment of the Court below.

REASONS FOR THE ALLOWANCE OF THE WRIT

This writ of certiorari is sought because the issues presented herein raise important questions of Federal law.

1. The United States Court of Appeals for the Seventh Circuit's judgment and opinion entered by the Court on the 25th day of August, 1981, overlooked and misapprehended the state of the record and the applicable rules of law pertaining thereto; that the subject appeal is of exceptional importance, and that the Seventh Circuit Court's opinion is at variance with decisions of the United States Supreme Court and other Courts of Appeal.

2. The rulings of the United States Court of Appeals for the Seventh Circuit concerning conspiratorial responsibility of the Petitioner are contrary to the law established in *Sundstran Corporation* v. *Sun Chemical Corporation,* 533 F. 2d 1033 (7th Cir. 1977), and depart from the requisite intent requirements in Rule 10(b)-5 cases, established in *Johns Hopkins University* v. *Hutton,* 488 F. 2d 912 (Cert. den. 416 U. S. 916, 94 Sup. Ct. 1622; are in conflict with the rule established in *Blue* v. *United States,* 138 F. 2d 351 (6th Cir. 1943); and that should this Court's rulings and opinions be allowed to stand, it would establish dangerous new precedent in the Federal Courts creating unlimited vicarious liability in Rule 10(b)-5 cases and open the floodgates of litigation among unhappy investors and failed investment organizations.

3. The interchangeable use of a conspiracy doctrine in civil as well as penal proceedings opens it to the danger, absent in the case of many crimes; that a Court having in mind civil sanctions will approve lax practices which are imported from criminal proceedings. In civil proceedings there must be a greater showing of the intent of a party to violate the securities acts. In dispensing with the necessity for specific intent to produce a result violative of statute, the Courts would cripple the Securities Acts as they were intended to be imposed by Congress. In the instant case, the Court has dispensed with even the necessity to infer any definite agreement, although that is the gist of the liability imposed upon STROUP, the Petitioner herein. If this Court should fail to act, the lower Courts may continue condoning an absence of proof in alleged conspiratorial 10(b)-5 cases.

4. The award of damages for Dr. CHADBOURN was unsupported by any evidence in the record of trial and such issues could not have been submitted to the jury since the threshold burden of presenting "some evidence" had not been met by Dr. CHADBOURN. The Appellate Court's decision is contrary to the rule established in *Medi-Group* v. *Schildknecht, et al.*, 463 F. 2d 525 (7th Cir. 1972) which requires a Plaintiff to show that he has actually sustained a loss before he can actually recover damages; and that the Appellate Court's ruling and opinion are contrary to *Alover Distributors, Inc.* v. *Kroger*, 513 F. 2d 1137 (7th Cir. 1975). The allowance of damages without presenting evidence on the issue denies the Petitioner rights of due process as guaranteed by the Fifth and Fourteenth Amendments of the United States Constitution.

5. The Appellate Court's interpretation of Federal Rules of Evidence, Rule 801(d)(2) is contrary to the mandates of this Court as set down in *Krulewitch* v. *United States*, 336 U. S. 440, 69 S. Ct. 716, 93 L. Ed. 2d 790 (1949) and overlooks the foundational requirements for the admission of conspiratorial evidence; that the Appellate Court's interpretation of such

evidentiary requirements would establish new precedent contrary to the law established in the Courts of Appeal in other United States circuits and law established in the United States Supreme Court.

ARGUMENT

I.

Whether the Alleged Participation by STROUP in a Conspiracy Would Cause STROUP to Be Liable to Plaintiffs for Any Purported Losses Incurred From Purchases Made and Sustained Subsequent to the Time STROUP Terminated and Severed His Relationship With the Alleged Conspiracy and Co-Conspirators.

Whether the Defendant STROUP is to be charged with conspiracy or aiding and abetting as a secondary Defendant, certain requisite matters must be shown by the Plaintiff by a preponderance of the evidence.[1] The first and the foremost of these requirements is that an independent illegal act or venture exists. Certainly such a showing is completely absent from the record in this trial. The Plaintiff merely testified that he had made purchases of additional Limited Partnership interests in other limited partnerships which were offered by FINANCIAL

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[1] In a scholarly dissertation written by Professor David S. Ruder in the University of Pennsylvania Law Review, Volume 120, Page 597 (1972), the Professor discusses, at some length, the liability of the secondary defendant. On Page 628, the Professor states:

> "Whether the liability of the secondary defendant is based upon conspiracy or aiding and abetting, an independent illegal act or venture must exist to which he can attach himself either by agreement or by action."

On Page 620, the Professor further states:

> "Once the independent wrong has been established, aiding and abetting liability will depend upon a showing that the Defendant knew of the wrong and gave assistance to the wrongdoer. Conspiracy liability will require such knowledge plus an agreement with the wrongdoer."

In referring to knowledge, he states on Page 638:

> "... knowledge can be shown by reckless conduct or through inference."

(Footnote continued on following page.)

PROFILES, INC. At no time during any of the testimony did the Plaintiff allege an illegal act or venture in those partnerships nor did he show by even a scintilla of proof that such an illegal act or venture existed. In *Securities and Exchange Commission* v. *Coffey,* 493 F. 2d 1304 (6th Cir. 1974), the Court in addressing this matter stated:

> "Knowledge that a Securities Law violation would be furthered by one's silence or inaction, however, must be proven by reliable and probative evidence .... though the evidence may be circumstantial as well as direct. Were such proof not required, a person who is not primarily liable for a violation could yet be held personally liable for the violation, even though he or she was unaware of the need to disclose information withheld by those primarily liable. The result would be to impose liability for an innocent omission, for non-culpable action ...
>
> Sec. 10(b) of the 1934 Act does not impose liability for innocent acts, but only for acts of fraud or deceit."

In *Rochez Bros., Inc.* v. *Charles R. Rhoades, et al,* 527 F. 2d 880 (3rd Cir. 1975), the Court there, in addressing a matter in an attempt to impose secondary liability to a corporation as an aider and abetter, stated:

> "To impose liability as an aider-abetter under this Section, it is necessary to find three (3) distinct elements: (1) the existence of an independent wrongful act; (2) knowledge by the aider and abetter of that wrongful act; and (3)

(Footnote continued from preceding page.)

The Professor goes on at some great length to discuss the difficulty in establishing a civil conspiracy and, raises some salient points that he feels should be considered by a Court in its inquiry into civil conspiracy. Some of these points are:

> "Did one of the conspirators carry out an overt act in furtherance of the conspiracy?"
>
> "Did it tend toward accomplishment of the intended illegal act of the conspiracy and did the person performing the act know and intend that it be such a step?"

> substantial assistance in affecting that wrongful act." "If liability is to be imposed on a secondary defendant, the Plaintiff must show a knowing participation or conscious involvment in the fraudulent scheme. In cases that have held an aider and abetter liable, the Courts have consistently found an involvement in the actual scheme." "Liability may be established whether the secondary defendant was directly or indirectly involved in the fraud . . . and may premised on inaction and only if it is apparent that the inaction intentionally further defraud or prevented its discovery." "Inaction alone cannot be a basis for liability." "The Appellant would have been required to show that the Defendant's inaction was deliberate and done intentionally to further the fraud."

(See: *Sanders* v. *Nuveen & Co.*, 554 F. 2d 79 (7th Cir. 1977)

An additional element was added to the above in the *Equity Funding Corporation of American Securities Litigation*, 416 F. Supp. 161 (1976-D. C. C. D. Cal.) where the Court said:

> ". . . in addition to (citing the above elements), the Plaintiffs must also show some casual connection between the conduct of the aider and abetter and the harm done Plaintiffs by the principal before liability can attach to the conduct of the aider and abetter."

Once again, the essential elements must be proven by a preponderance of the evidence; the existence of the wrongful act, the knowledge of that wrongful act by the aider and abetter and substantial assistance in affecting that wrongful act. As to each of the purchases made by the Plaintiff TUCKER, subsequent to the purchases of GALLERY LIMITED PARTNERSHIP, the Plaintiff has failed to present one (1) shred of evidence showing an independent wrongful act in any of the partnerships, nor any knowledge on the part of STROUP of that wrongful act nor any assistance by STROUP in affecting the wrongful act. Defendant's contention is that the possible omissions by STROUP of certain material facts in the sale of limited partnership interests in GALLERY LIMITED PARTNERSHIP cannot be carried over to subsequent sales of interests in distinctly different entities. Without the showing of

any wrongful act by STROUP in those entities, he may not be charged with a violation of the Securities Act in those sales. The theory that STROUP could be charged with wrongful acts in subsequent sales is patently adverse to the laws dealing with civil conspriracy and the laws dealing with aiding and abetting under the Securities Act. STROUP's resignation on November 27, 1971 as officer and director of FINANCIAL PROFILES, INC. effectively terminated any relationship with that corporation. There have been no violations of Rule 10(b)-5 shown to have been committed by that corporation in subsequent sales of these partnership interests nor has there been any evidence adduced which would show Defendant STROUP's involvement in any scheme.

The Court of Appeals was correct in stating that STROUP admitted a private cause of action was permissible for violations under Rule 10(b)-5. (See *Ernst & Ernst* v. *Hochfelder*, 425 U. S. 185). However, the standards imposed by this Court require proof of intent or *scienter* throughout the Plaintiff's case on trial. Their arguments relating to Rule 10(b)-5 concern mis-statements or omissions of the Defendant STROUP. Having proved no mis-statements or omissions by STROUP relating to the various 21 unsuccessful investment securities, the Plaintiffs advised the District Court that they would go to the jury solely as to violations of Rule 10(b)-5. The Plaintiffs abandoned their causes of action as they related to Section 12(2) of the Securities Act of 1933 and remedies fashioned around Section 77(q) (15 U. S. C. Sec. 77(q). Rule 10(b)-5 actions have been fashioned by the Court arising out of intentional conduct by individuals involving mis-statements and willful omissions to state material facts pertaining to securities. The Court's fashioning of this remedy derives from the Securities Acts of 1933 and 1934 and civil remedies provided therein. Both 15 U. S. C. Section (77)(l) and Section 77(q) provide for certain civil remedies for alleged wrongs. These remedies are distinctly different in that they provide for dissimilar elements of proof.

At trial, the Plaintiffs made no distinction in their proof and presented evidence of negligence rather than intentional conduct to sustain their cause of action against STROUP. Furthermore, they extended their theory of negligence so as to involve STROUP as a co-conspirator or aider and abetter in a scheme to defraud Drs. TUCKER and CHADBOURN. In essence, STROUP is alleged to have negligently entered a conspiracy without proof of any affirmative or intentional act on his part to defraud the Plaintiff.

Negligence is insufficient to sustain the Plaintiff's burden under Section 77(q) (See *Johns Hopkins University* v. *Hutton*, 488 F. 2d 912, cert. den. 416 U. S. 916, 94 S. Ct. 1622). Congress' intent in creating a remedy under Section 77(q) was to require an alleged wrong party to prove a willful or intentional act on the part of an individual to defraud or misrepresent facts material to a security offered or to be offered. It would be improper for the Courts to extend a remedy unknown at common law, created by statute, providing for vicarious liability involving "negligent conspiracy."

From the formation of the Limited Partnership under April, 1972, Plaintiffs claim Defendant STROUP to be liable under a theory of conspiracy or as an aider and abetter. Plaintiffs incorrectly claim that STROUP does not challenge the existence of a conspiracy and have ignored STROUP's argument supported by *United States* v. *DeMarco*, 44 F. 2d 828, 832 (2d Cir. 1973). In *DeMarco*, the Court stated that "a person cannot conspire to commit a specific crime unless he is aware of all the elements of the crime." Plaintiffs also failed to consider the basic requirement that the common objective of a conspiracy must be to do a wrongful act. If no wrongful act is manifested in the design of two (2) or more parties, no overt act in advancement of a conspiracy has been effected and less than two (2) parties have joined together for the purpose of the alleged conspiracy, there is no conspiracy. *United States* v.

Crimmins, 123 F. 2d 271, 273 (2d Cir. 1941). What Plaintiffs have argued is a morass of isolated items of information allegedly omitted. Most of the items have no materiality to the value of the security at the time of purchase, or Plaintiffs knew or had reason to know of their existence. Plaintiffs have claimed that STROUP, JANOTA and PITT *jointly* omitted to tell them of these facts variously over three (3) to five (5) years. Aside from the lack of time frame for the alleged failures to provide information Plaintiffs beg the issue of conspiracy prior to April, 1972. The requirement of the Plaintiffs was to show a particular act in the furtherance of a conspiracy, not a mere association or vague agreement to do something wrong. *U. S.* v. *Rosenblatt,* 554 F. 2d 36 (2d Cir. 1977). The error and confusion created by the effusion of all the immaterial allegations of conspiracy only served to confuse the jury, and the prejudicial effect of such evidence without the special instruction requested prevented a proper deliberation of the issue as to whether STROUP could be held upon alleged omission which he knew nothing about.

If there is a claim of conspiracy, it must arise under Section 77(q) in that conspiracy portends to be an intentional act of two (2) or more parties. In arguendo, even if Defendant STROUP was to concede he negligently omitted to inform the Plaintiffs with material information about their investment, such a fact is insufficient to support a claim under Section 77(q) individually, and certainly not as a co-conspirator.

When STROUP withdrew from GALLERY LIMITED PARTNERSHIP in April, 1972 and from all other activities, Plaintiffs allege a continued responsibility on the part of STROUP becasue he did not defeat or disavow the alleged wrongful goal of the conspiracy. As such, Plaintiffs allege that any act, any investment or any activity undertaken by the remaining Defendants would bind STROUP as if he had committed them himself. There is no question that STROUP

withdrew from the Partnership operation and attendant responsibilities of the Trust and the corporation. In *Blue* v. *United States,* 138 F. 2d 351 (6th Cir. 1943), the Defendant was held to have withdrawn from a fraudulent scheme after he had tendered his resignation by letter and thereafter had no additional connection with the project. The Court held that

> "To hold that a former participant, who had ended his association with the scheme long before the mails were used, is an aider or abetter in causing the use of the mails in furtherance of the scheme, would be too novel a construction of an already sufficiently extended application of criminal law."

It should be the Court's pleasure in terminating the growth of a concept in Federal law which makes an innocent and unknowing party liable for the acts of others which were unknown and unsanctioned by him at the time of their commission. Conspiracy through negligence is without precedent in the common law and unintended in the creation of the Securities Acts of 1933 and 1934.

II.

The Court's Ruling Allowing Hearsay Testimony as to Conversations Subsequent to Defendant's Withdrawal Was Error.

The Defendant STROUP raises the issue of the admissibility of testimony offered by TUCKER and MUELLER, one of the other Defendants, which was admitted over the objection of the Defendant during trial. The Defendant objected to the admission of such testimony in that the matter contained in that testimony was admitted for the truth of the matter contained therein. The testimony concerned itself with out of court statements made after the time STROUP had had any participation in the operation of GALLERY LIMITED PARTNERSHIP, FINANCIAL PROFILES, INC., or other businesses related to the Complaint of the Plaintiffs.

The conspiracy evidence rule, which is now included in Rule 801 of the Federal Rules of Evidence, was originally established by Court decision as an exceptance to the hearsay rule. The Rules of Evidence, however, no longer classifies conspiratorial declarations as hearsay on the theory that they are a species of admission by a party opponent. Simply stated, Rule 801 of the Federal Rules of Evidence provides that statements made by a co-conspirator are admissible against other co-conspirators only if they are made in the furtherance of a conspiracy. *United States* v. *Nixon,* 418 U. S. 683, 94 S. Ct. 3090, 41 L. Ed. 2d 1039 (1974); *Wong Sun* v. *United States,* 371 U. S. 471, 83 S. Ct. 407, 9 L. Ed. 2d 441 (1963), *Krulewitch* v. *United States,* 336 U. S. 440, 69 S. Ct. 716, 93 L. Ed. 790 (1949).

The Court was emphatic in condemning the advancement of the concept of conspiracy and the allowance of hearsay testimony to prove conspiracy issues.[2] STROUP did not deny

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[2] The Court in Krulewitch stated:

"Attribution of criminality to a confederation which contemplates no act that would be criminal if carried out by any one of the conspirators is a practice peculiar to Anglo-American law. 'There can be little doubt that this wide definition of the crime of conspiracy originates in the criminal equity administered in the Star Chamber.' In fact, we are advised that 'The modern crime of conspiracy is almost entirely the result of the manner in which conspiracy was treated by the court of Star Chamber.' The doctrine does not commend itself to jurists of civil-law countries, despite universal recognition that an organized society must have legal weapons for combatting organized criminality. Most other countries have devised what they consider more discriminating principles upon which to prosecute criminal gangs, secret associations and subversive syndicates . . .

When the trial starts, the accused feels the full impact of the conspiracy strategy. Strictly, the prosecution should first establish prima facie the conspiracy and identify the conspirators, afte

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ownership in the General Partnership at its organizational stage. He had sold his interest in such partnership prior to the time of the alleged misconduct which was to have occurred

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which evidence of acts and declarations of each in the course of its execution are admissible against all. But the order of proof of so sprawling a charge is difficult for a judge to control. As a practical matter, the accused often is confronted with a hodgepodge of acts and statements by others, which he may never have authorized or intended or even known about, but which help to persuade the jury of existence of the conspiracy itself. In other words, a conspiracy often is proved by evidence that is admissible only upon assumption that conspiracy existed. The naive assumption that prefudicial effects can be overcome by instructions to the jury. cf. *Blumenthal* v. *United States,* 332 U. S. 539, 559, all practicing lawyers know to be unmitigated fiction. See *Skidmore* v. *Baltimore & Ohio R. Co.,* 167 F. 2d 54.

The trial of a conspiracy charge doubtless imposes a heavy burden on the prosecution, but it is an especially difficult situation for the Defendant. The hazard from loose application of rules of evidence is aggravated where the Government institutes mass trials. Moreover, in federal practice there is no rule preventing conviction on uncorroborated testimony of accomplices, as there are in many jurisdictions, and the most confort a defendant can expect is that the Court can be induced to follow the "better practice" and caution the jury against "too much reliance upon the testimony of accomplices." *Caminetti* v. *United States,* 242 U. S. 470, 495.

A co-defendant in a conspiracy trial occupies an uneasy seat. There generally will be evidence of wrongdoing by somebody. It is difficult for the individual to make his own case stand on its own merits in the minds of jurors who are ready to believe that birds of a feather are flocked together. If he is silent, he is taken to admit it and if, as often happens, co-defendants can be prodded into accusing or contradicting each other, they convict each other. There are many practical difficulties in defending against a charge of conspiracy which I will not enumerate .....

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during the two (2) years after he had sold his interest. It is elemental, of course, "that a person cannot conspire to commit a specific crime unless he is aware of all of the elements of the

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It is difficult to see any logical limit to the "implied conspiracy," either as to duration or means, nor does it appear that one could overcome the implication by express and credible evidence that no such understanding existed, nor any way in which an accused against whom the presumption is once raised can terminate the imputed agency of his associates to incriminate him. Conspirators, long after the contemplated offense is complete, after perhaps they have fallen out and become enemies, may still incriminate each other by deliberately harmful, but unsworn declarations, or unintentionally by casual conversations out of court. On the theory that the law will impute to the confederates a continuing conspiracy to defeat justice, one conceivably could be bound by another's unauthorized and unknown commission of perjury, bribery of a juror or witness, or even putting an incorrigible witness with damaging information out of the way.

Moreover, the assumption of an indefinitely continuing offense would result in an indeterminate extension of the statute of limitations. If the law implies an agreement to cooperate in defeating prosecution, it must imply that it continues as long as prosecution is a possibility, and prosecution is a possibility as long as the conspiracy to defeat it is implied to continue.

I do not see the slightest warrant for judicially introducing a doctrine of implied crimes or constructive conspiracies. It either adds a new crime or extends an old one. True, the modern law of conspiracy was largely evolved by the judges. But it is well and wisely settled that there can be no judge-made offenses against the United States and that every federal prosecution must be sustained by statutory authority. No statute authorizes federal judges to imply, presume or construct a conspiracy except as one may be found from evidence. To do so seems to approximate creation of a new offense and one that I would think of doubtful constitutionality even if it were created by Congress. And, at all events, it is one fundamentally and irreconcilably at was with our presumption of innocence.

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crime." *United States* v. *DeMarco,* 44 F. 2d 828, 832 (2d Cir. 1973). In *DeMarco,* the Court adopted the reasoning of Judge Learned Hand in stating:

> "While one may, for instance, be guilty of running past a traffic light of whose existence one is ignorant, one cannot be guilty of conspiring to run past such a light, for one cannot agree to run past a light unless one supposes that there is a light to run past." *United States* v. *Crimmons,* 123 F. 2d 271, 273 (2d Cir. 1941).

See *United States* v. *Crimmins,* 123 F. 2d 271, 273 (2d Cir. 1941), from this, it follows that the Plaintiffs were required to prove that Defendant STROUP had specific awareness of any omission or misstatement which was to have occurred after his withdrawal from the alleged conspiracy. It was insufficient that the Plaintiffs merely showed STROUP had originally been

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> There is, of course, strong temptation to relax rigid standards when it seems the only way to sustain convictions of evildoers. But statutes authorize prosecution for substantive crimes for most evil-doing without the dangers to the liberty of the individual and the intregrity of the judicial process that are inherent in conspiracy charges. We should disapprove the doctrine of implied or constructive crime in its entirety and in every manifestation. And I think there should be no straining to uphold any conspiracy conviction where prosecution for the substantive offense is adequate and the purpose served by adding the conspiracy charge seems chiefly to get procedural advantages to ease the way to conviction.
>
> Although a reversal after four trials is, of course, regrettable, I cannot overlook the error as a harmless one. But I should concur in reversal even if less sure that prejudice resulted, for it is better that the crime go unwhipped of justice than that this theory of implied continuance of conspiracy find lodgment in our law, either by affirmance or by tolerance. Few instruments of injustice can equal that of implied or presumed or constructive crimes. The most odious of all oppressions are those which mask as justice."

associated with the business transactions prior to any alleged wrongdoing. It was equally insufficient to conclude from evidence introduced that there was a subsequent conspiracy between STROUP and other Defendants. Furthermore, the requirement of the Plaintiffs was to show a particular act in the furtherance of a conspiracy, not a mere association or vague agreement "to do something wrong." *United States* v. *Rosenblatt,* 554 F. 2d 36, 38-40 (2nd Cir. 1977).

Plaintiffs must show that STROUP's connection with the alleged conspiracy was established by non-hearsay sufficiently to permit admission of the testimony of any other alleged co-conspirator. This is a threshold requirement. Admissions of third party statements for the truth of such matters are inadmissible. The threshhold requirement of the Plaintiffs was to introduce by a "fair preponderance of the evidence, independent of the hearsay utterances" acts by the Defendant in the furtherance of the alleged conspiracy. *United States* v. *Provenzano,* 615 F. 2d 37 (2nd Cir. 1980). The Plaintiffs failed to introduce any evidence to show Defendant's continuing activity during the three (3) year period commencing after Defendant's withdrawal from business operations or any other act or omission through non-hearsay. Having failed to meet the threshold requirement as a foundation, the hearsay testimony of TUCKER and MUELLER was outside Rule 801.

Although discussed elsewhere in this Brief, the argument could be made that the submission of special instructions might cure the prejudicial effect of hearsay declaration heard by the jury. The Court overruled the objection as to hearsay and further rejected any cautionary or special instructions which would have permitted the jury to disregard activities allegedly committed by other Defendants during the period after STROUP's withdrawal from the partnership. Courts have recognized that there is a danger in conspiracy trials involving numerous Defendants because of their association with other Defendants. See *United States* v. *American Radiation,* 433 F.

2d 174 (3rd Cir. 1970) Cert. Denied 401 U. S. 948, 28 L. Ed. 2d 231 (1971). One aspect of this danger is that the trial jury, after admitting hearsay declaration of alleged conspirators, may find, at the close of all evidence, that the Plaintiff has not borne its burden of proof by independent evidence, i. e., that those declarations were made during the course and in the furtherance of a conspiracy joined in by both the Defendant and the Declarant. See *United States* v. *Bey*, 437 F. 2d 188 (3rd Cir. 1971).

The constitutional issue is raised as to whether or not Defendant is deprived of his right to cross-examine the Declarant on out-of-court testimony. The fundamental reason for the rejection of hearsay other than on a constitutional basis (U. S. Constitution, Amend. Six) is that it simply lacks trustworthiness. Where the witness testifies in Court, the jury can evaluate his credibility, sincerity, and his ability and knowledge of the facts and the validity of his memory. However, where evidence is offered as to the declarant's statements or conduct outside of the Court, the jury simply cannot ascertain or evaluate these factors as they were not there at the time of the statement or conduct. If Rule 801 is to encompass adoptive admissions, i.e., the adoption of admissions of other Defendants by Defendant STROUP, the words or conduct must be known and voluntarily adopted by Defendant STROUP. If Rule 801 encompasses vicarious admissions, i.e., admissions made by third persons imputed to Defendant STROUP, then such admissions must meet the following criteria:

(a) the existence of the agency and the agent's authority;

(b) the statements were made within the scope of the agent's authority, and

(c) that the defendant knew or had reason to know that such statements were made.

(See the Restatement of Agency, Sec. 286).

The requirements in this case clearly require that four (4) elements be proven by Plaintiffs prior to the admission of the hearsay statements heretofore referred to above. The first requirement is that the conspiracy is properly established by independent evidence; the second requirement is that the admission is made within the course of conspiracy; the third requirement is that the admission relates to a matter involved in the conspiracy itself, and the fourth is that the admission must be a matter in furtherance of the conspiracy. Id. 336 U. S. at 440. The Plaintiffs failed to meet this burden and therefore the testimony of TUCKER and MUELLER should not have been admitted. As a result of such admission, the Defendant STROUP was prejudiced, because the jury was permitted to hear such testimony. The evidence was used to support the contention that a continuing responsibility on the part of STROUP existed after he had withdrawn from further business with other Defendants.

III.

The Decision of the Jury Was Unsupported by Evidence in Finding Damages for Plaintiff CHADBOURN.

Defendant STROUP raised the issue of absence of proof to support the pleadings on behalf of Plaintiff DR. CHADBOURN at trial. Defendant contends that no evidence was adduced from any witness or through any documentary proof supporting DR. CHADBOURN's claims alleged in his Complaint. The record is devoid of any evidence, whatsoever, showing that DR. CHADBOURN was a victim of a mis-statement from any Defendant, nor was DR. CHADBOURN a party to any omission of fact which a reasonable investor would rely upon to make an investment. In actuality, DR. CHADBOURN never appeared at trial during any part of the proceedings. No testimony was received even commenting upon his participation in any business or having any reference

to any investment he may have made with any defendant or business organization which was the subject matter of the litigation. An examination of the entire record will disclose DR. CHADBOURN's name being mentioned only twice: Once in the pleadings and once in commentary before the Court without the jury present, advising the Court that DR. CHADBOURN would not be able to be present because of his lack of transportation to the courthouse.

The principal requirement of any Plaintiff at trial is to at least submit proof supporting his cause of action as pleaded in his Complaint. If the Plaintiff shall fail to show a prima facie case by competent evidence, his cause of action should be dismissed or judgment should be granted to Defendant. FRCP. Rule 54 (28 U. S. C. Rule 56). An absence of proof at the close of Plaintiff's case should have mandated the trial court to enter judgment for Defendant STROUP and against the Plaintiff CHADBOURN. The Court denied Defendant's Motion for Judgment even in the face of not one scintilla of evidence introduced to support CHADBOURN's claim. This, in itself, is plain error, but the Court's decision to allow the jury to consider the issue of DR. CHADBOURN's claim against Defendant STROUP created a prejudicial atmosphere among the jurors. It must be remembered that a jury which has not been instructed to disregard incompetent evidence or which is charged with deciding issues without a correct perspective of the evidence, cannot properly weigh evidence it has heard during trial. From the jury's perspective, the Court charged them with deciding the guilt of Defendant STROUP as to the claims of both TUCKER and CHADBOURN. The jury had heard nothing as to CHADBOURN but had heard evidence as to TUCKER. It is only speculative as to how profound the effect was of a charge to this jury, commanding them to consider one claim supported by some evidence together with a claim completely unsupported. It is clear, however, that such a confusing task could only be prejudicial to the Defendant.

In this case, the Plaintiff CHADBOURN had the burden of proving by a preponderance of the evidence that he was a purchaser of the security in question, that there was a mis-statement, non-disclosure or scheme to defraud, that the non-disclosure or mis-statement was of a material fact, that there was reliance or a causal relationship between the mis-statement or omission and the injury, and that Defendant STROUP acted with a mental state embracing an intent to deceive, manipulate or defraud. *Franklin Life Insurance Company* v. *Commonwealth Edison Company,* 451 F. Supp. 602. The Plaintiff CHADBOURN was further required to show his damages. No evidence was introduced to show any loss or damages arising out of the complained wrongdoing allegedly committed by the Defendants. A jury may not render a verdict based on speculation or guesswork, even where Defendant by his own wrong has prevented a more precise computation. *Ohio Valley Electric Corp.* v. *General Electric Co.,* 244 F. Supp. 914 (D. C. N. Y. 1965). In order for DR. CHADBOURN to recover for any alleged damages, facts affording a reasonable basis for computation of damages for which Defendant was liable was required to be established. In the absence of showing what, if any, damages were due to a cause or causes for which Defendant may be liable, DR. CHADBOURN should recover no part of any judgment rendered on his behalf. *Moran Towing Company* v. *M. A. Gammino Construction Company,* 244 F. Supp. 729 (D. C. R. I. 1965); *Vancover Plywood Co., Inc.* v. *National Automobile and Casualty Insurance Co.,* 387 F. Supp. 311 (D. C. W. D. La. 1975).

CONCLUSION

For the reasons stated herein, this Court should issue its writ of certiorari to the United States Court of Appeals for the Seventh Circuit to review its judgment of August 25, 1981, affirming the judgment of the District Court of the United States for the Northern District of Illinois, Eastern Division, to the end that its judgment be reversed with direction to reverse the judgment below.

Respectfully submitted,

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APPENDICES

APPENDIX A

United States Court of Appeals

For the Seventh Circuit
Chicago, Illinois 60604
Argued May 13, 1981
August 25, 1981

Before

Hon. WALTER J. CUMMINGS, Chief Judge
Hon. WILBUR F. PELL, JR., Circuit Judge
Hon. EARL R. LARSON, Senior District Judge *

FRANCIS C. TUCKER and
CHARLES R. CHADBOURN,
Plaintiffs-Appellees,

No. 80-2155 *vs.*

CLYDE L. STROUP,
Defendant-Appellant.

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division.
No. 75 C 2931
Bernard M. Decker, Judge.

ORDER

In their amended complaint, plaintiffs Francis C. Tucker and Charles R. Chadbourn, both practicing Illinois physicians, sued Clyde L. Stroup, a Chicago dentist, and others for violations of the federal and Illinois securities laws and also for breach of their common law fiduciary duties. The jury awarded

* The Honorable Earl R. Larson, Senior Judge of the District of Minnesota, is sitting by designation.

Tucker $115,000 and Chadbourn $35,000; judgments were entered in their favor on these verdicts. Thereafter Stroup appealed. We affirm.

When the amended complaint was filed in September 1976, there were many additional plaintiffs and defendants. However, through attrition settlements and dismissals, many of the parties dropped out[1] and the trial involved here concerned only Tucker's and Chadbourn's (plaintiffs) claims against Stroup under Section 10(b) of the Securities Exchange Act of 1934 and Securities and Exchange Commission Rule 10b-5 thereunder. Section 10(b) of the 1934 Act makes it "unlawful for any person * * * to use or employ, in connection with the purchase or sale of any security * * * any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors." 15 U. S. C. § 78j. Pursuant to Section 10(b), the SEC promulgated Rule 10b-5 which provides:

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[1] Originally there were 26 plaintiffs and 31 defendants. Prior to trial, various defendants were dismissed and certain plaintiffs reached settlements with defendants Cornelius Pitt, Robert V. Mueller, United of America Bank and Michigan Avenue Bank. Defendant Lawrence Janota defaulted. A few weeks after judgments were entered on the verdicts in favor of plaintiffs Tucker and Chadbourn, a default judgment order was entered against defendants Janota, Financial Profiles, Inc., Profiles Corporation, Wheeling II Limited Partnership, Wheeling Condominium Trust I and Wheeling Condominium Trust II in the amount of $2,049,295.06 plus interest. The record does not disclose what was done as to the remaining defendants at the meeting scheduled for September 28, 1980, before Judge Decker.

This appeal was docketed on August 25, 1980. The firm of Chapman and Royce Ltd. has been sole counsel on appeal for plaintiffs-appellees. Their notice of appearance was entered on September 30, 1980.

"Employment of manipulative and deceptive devices.

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

"(a) To employ any device, scheme, or artifice to defraud,

"(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

"(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

"in connection with the purchase or sale of any security."

According to the amended complaint, defendant Financial Profiles, Inc. was an Illinois corporation doing business there and solicited sales of "tax shelters" from plaintiffs in projects that were unsuccessful. Financial Profiles and its principal officers are alleged to have falsely and fraudulently represented to plaintiffs that they would receive a guaranteed minimum return on their investments, that the investments were economically sound, and that all their invested capital would be returned to plaintiffs. Defendants' alleged fraudulent scheme involved the sale of limited partnership interests in 21 or more real estate projects sold to plaintiffs, who paid for them through purported loans. Defendants supposedly failed to disclose to plaintiffs various material facts about the investments, including the many risks, the financial condition of the investment opportunities, and the identity of the principals involved in the investments. Defendants were charged with having entered into a deceptive and manipulative course of conduct in connection with the offering for sale of their securities. The foregoing conduct of the defendants was said to violate Section 10(b) of the Act because they employed devices to defraud

plaintiffs in connection with the sale of partnership interests and beneficial interests in defendant partnerships and condominium trusts and convertible preferred stock in defendant National American Corporation and in arranging purported loans for plaintiffs with Michigan Avenue National Bank and United of America Bank, both of Chicago. Defendants are said to have violated Rule 10b-5 by making false statements which induced plaintiffs to purchase securities and obtain loans and to sell certificates of indebtedness to banks. They are also said to have failed to disclose material facts necessary to enable plaintiffs to understand the nature of risk and loss with respect to securities, including loans and certificates of indebtedness. Defendants' scheme or conspiracy was described as a deceptive and manipulative course of conduct operating as a fraud or deceit upon plaintiffs, again in violation of Section 10(b) and Rule 10b-5. The amended complaint also relied on other provisions of the federal securities laws, the Illinois Securities Act and on defendants' common law breach of fiduciary duty as investment advisors to plaintiffs. However, at the close of the evidence, plaintiffs advised the district court that they would go to the jury solely as to violations of Rule 10b-5 (Tr. 399). Therefore, the instructions were tailored to a Rule 10b-5 case.

The Evidence Supports the Jury Verdicts

First of all, defendants admit that plaintiffs were purchasers of securities. They also admit that a private cause of action is permissible for violations under Rule 10b-5. *Ernst & Ernst* v. *Hochfelder,* 425 U. S. 185, 196-197, and cases cited. Defendants concede, in accordance with *Affiliated Ute Citizens* v. *United States,* 406 U. S. 128, 152-154, and *Johns Hopkins University* v. *Hutton,* 422 F. 2d 1124, 1129 (4th Cir. 1970), that plaintiffs need not establish that they relied upon any misstatements or omissions of defendants but merely had to establish that a reasonable and prudent investor would have so relied.

To show that the verdicts were supported by the evidence, plaintiffs state that the sale to them of limited partnership interests in the Gallery Limited Partnership, for example, violated Rule 10b-5 because of defendant's fraudulent misrepresentation and omissions in the following six areas:

(1) Assurances of 10% return on investments

(2) Commissions to Financial Profiles and Gallery Investment Trust

(3) Self-dealing by principals

(4) Profit to principals in the sale

(5) Non-disclosure of the investment's true value

(6) Stroup's role as a financial advisor and failure to disclose investment risk

We have examined the evidence with respect to those six areas and are satisfied that Dr. Stroup knew, or should have known, of the misrepresentations and non-disclosures and was a participant in the alleged conspiracy or scheme to defraud plaintiffs, including their subsequent investments in four other projects. For the sake of brevity, we will not set out the supporting evidence except to say that under the district judge's unchallenged instructions the jurors were permitted to rely upon circumstantial evidence (Tr. 449-450) and were entitled to draw reasonable inferences therefrom. Consequently the reply brief is erroneous in accusing plaintiffs of misreading the record.

In order to absolve himself of all responsibility for anything other than Gallery Limited Partnership, in which plaintiffs had invested at Financial Profiles' urging in December 1971, Stroup insists he was out of the conspiracy before plaintiffs made their other investments. However, the jury could find that while Stroup was the president of Financial Profiles, Inc. through the activation of the Gallery Limited

Partnership in December 1971, he actually did not get out of the scheme even when he traded his interest in the Gallery Investment Trust to Gallery Enterprises on April 30, 1972. As defendant Mueller explained, the original conspiracy included such future deals as were made with plaintiffs, thus binding Stroup as to them. *Dasho* v. *Susquehanna Corporation,* 380 F.2d 262, 267 n. 2 (7th Cir. 1967), certiorari denied, 389 U.S. 977; see also *United States* v. *Forszt,* ____ F.2d ____ (7th Cir. July 27, 1981); *United States* v. *Meyers,* 529 F.2d 1033 (7th Cir. 1976), certiorari denied, 429 U.S. 894. Because of Stroup's activities after his purported resignation from Financial Profiles on November 22, 1971, because he tolerated further sales of tax shelters to plaintiffs and others at least until he sent reports in 1974 to the investors in Gallery Enterprises and the Gallery Limited Partnership, the jury was instructed without objection that Stroup could not prove withdrawal from the conspiracy unless he showed that "he took some affirmative action to disavow or defeat the purpose of the conspiracy" and that there would be no withdrawal if Stroup "participation in the concealment of the true financial condition of the investments * * *" or if he "left with his co-conspirators his contribution to the illegal scheme so that they are able to further the continuing fraudulent object of the conspiracy" (Tr. 476-477). Under the foregoing instructions the jury found that Stroup had not withdrawn from the conspiracy or scheme until after both plaintiffs were damaged after having been misled to invest $125,000 and $35,000 respectively in the various worthless projects. In our view their finding was justified by the evidence.

Judge Decker was also extremely careful in instructing the jury on the requirements of *scienter* or reckless disregard before they could find that Stroup had violated Rule 10b-5. He also instructed them carefully on aiding and abetting liability and properly defined conspiracy and the liability of co-conspirators. Since the instructions were correct and are not assailed by

defendant,[2] since there was sufficient evidence to hold Stroup liable as an aider and abettor or conspirator, and since there was sufficient evidence to support his culpability under the *scienter* or reckless disregard standards, we would be remiss in setting aside the verdicts and judgments thereon holding him liable to plaintiffs.

The Award of Damages Was Supported by the Evidence

The record showed that Dr. Tucker lost $30,000 in the Gallery Limited Partnership, $10,000 in the Riviera project, $50,000 in the Palmer Court project, $10,000 in the Wheeling project and $25,000 in the Bradenton project for a total of $125,000. The jury awarded him only $115,000, but at the oral argument we were told by counsel that this was because of an error in presentation. Nevertheless, Tucker is not seeking to recover the full $125,000.

In a separate verdict, the jury awarded Dr. Chadbourn $35,000, consisting of his $10,000 investment in the Gallery Limited Partnership, $10,000 in the Palmer Court project and $15,000 in the Bradenton project. None of these projects is presently in existence, and Dr. Tucker testified that none of his investments had been returned to him. Similarly, Dr. Chadbourn lost $35,000 in the defunct projects. Defendant elicited no evidence that any of the projects has any value.

When Judge Decker inquired of defense counsel whether each investment of plaintiffs "was worthless," defendant's counsel replied that plaintiffs "received nothing back" (Tr. 185). Dr. Stroup was unable to show any viability of any of these investments. Therefore, defendant's argument that the jury's award of damages to the plaintiffs was unsupported is without merit. In fact, under the instructions given, the jury

[2] Three of defendant's proposed instructions were refused but defendant has not brought up this point on appeal.

was told that plaintiffs were required to prove their damages under Rule 10b-5, and that the damages must be limited by the jurors to the plaintiffs' out-of-pocket losses. The jury was also told that the plaintiffs must prove by a fair preponderance of the evidence that they suffered their damages as the proximate cause of the misleading statements or omissions, and that they must prove their damages to a reasonable certainty.

Defendant has shown nothing justifying a reduction in the award of damages to Dr. Tucker but he questions whether Dr. Chadbourn had lost $35,000 in three of the projects of defendants. However, at the trial defendant never contested the fact that Chadbourn invested $35,000 in worthless Gallery Limited Partnership, Palmer Court and Bradenton projects. This is shown in plaintiffs' Exhibits 6-1 through 6-8 which went to the jury room. Therefore, it is baseless for defendant to contest the amount of Chadbourn's investments in these worthless enterprises. Chadbourn was of course exposed to the same misrepresentations and omissions as Dr. Tucker. He had given his deposition,[3] which was filed below on October 14, 1978, but was in such poor health that he could not appear as a trial witness as intended. In fact, he died on May 8, 1981, less than a year after the trial ended. The transcript shows that he was confined to a wheelchair at the time of the trial and was unable to make transportation arrangements to attend (Tr. 306). The amount of his investments in the defendants' companies having been shown, it was permissible for the jury to conclude that any reasonable investor such as Dr. Chadbourn would be influenced by the material misrepresentations and omissions that

[3] Parts of Dr. Chadbourn's deposition and other matters relating to his investments appear as an attachment to the Appendix to plaintiffs unsuccessful June 26, 1978, motion for summary judgment on Count XI of the amended complaint dealing with Section 7(c) of the Securities Exchange Act of 1934. That Appendix is part of the record before us.

support the liability of Stroup. We are unwilling to set aside the jury verdict awarding him the $35,000 he lost when undeniably exposed to the same conduct as the other investors, especially since proof of a plaintiff's reliance on omissions and misrepresentations is not a condition of recovery in a Rule 10b-5 case. *Affiliated Ute Citizens* v. *United States,* 406 U. S. 128, 152-154.

It Was Unnecessary to Submit a Special Verdict to the Jury

The submission of a special verdict is of course discretionary with the trial court. *Elston* v. *Morgan,* 440 F.2d 47, 49 (7th Cir. 1971); Rule 39(a) of the Federal Rules of Civil Procedure; 5A Moore's Federal Practice ¶ 49.03[1] (1980 ed.). No abuse of discretion has been shown here, particularly since the proposed special verdict form encompassed only two of the plaintiffs' six theories for recovery under Rule 10b-5.

Defendant's Evidentiary Objections Were Not Well Taken

Stroup objects to the admissibility of Dr. Tucker's testimony concerning a conversation between him and defendant Robert B. Mueller on December 8, 1971. At their meeting, according to Tucker, Mueller recommended that Tucker invest $10,000 in defendant Condominium Trust of America and told Tucker he could arrange a loan for Tucker through the Michigan Avenue National Bank. At the trial and now, defense counsel objected to the admission of this testimony on the ground that it was hearsay. Since Mueller was a defendant, his statements to Tucker would not be hearsay under the Federal Rules of Evidence because they qualified as admissions by a party opponent or as a statement by a co-conspirator during the course and furtherance of the conspiracy. See Rule 801(d)(2). In addition, the plaintiffs were not offering Mueller's testimony to prove the truth of the matter asserted but merely to show what Mueller told Tucker. Since the conversation was not

"offered in evidence to prove the truth of the matter asserted" by Mueller, it was not hearsay under Rule 801(c) of the Federal Rules of Evidence.

Defendant also objected to Mueller's testimony about the circumstances of a check bearing the legend "Gallery International payment, Loan to Gallery by F P Corporation." When Mueller started to testify that "the basis behind that [legend] was, as I assume, the fact that—," defense counsel objected and the objection was sustained (Tr. 260). Immediately thereafter, Mueller testified that the legend referred to by referring to a conversation he had with defendant Lawrence Janota (*ibid.*). Since there was no further objection, defendant has no cause to complain that Mueller was permitted to testify as to his September 10, 1973, conversation with Janota about this subject.

Not only was Judge Decker correct in receiving the foregoing testimony of Mueller, but the jury was instructed on the necessity of plaintiffs' establishing a common scheme or plan among defendants before the jury could consider the acts and declarations of alleged co-conspirators like Mueller and Janota.

Judgment affirmed.[4]

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[4] The proceeds of Dr. Chadbourn's $35,000 judgment will of course go to his Executor or Administrator. Cf. Rule 25(a) of the Federal Rules of Civil Procedure.

APPENDIX B

UNITED STATES COURT OF APPEALS
For the Seventh Circuit

Before

Hon. WALTER J. CUMMINGS, Chief Judge
Hon. WILBUR F. PELL, JR., Circuit Judge
Hon. EARL R. LARSON, Senior District Judge

FRANCIS C. TUCKER and CHARLES R. CHADBOURN, *Plaintiffs-Appellees,* vs. CLYDE L. STROUP, *Defendant-Appellant.*	Appeal from the United States District Court for the Northern District of Illinois Eastern Division. No. 75 C 2931 Judge Bernard Decker

No. 80-2155

PETITION FOR REHEARING IN BANC

The defendant-appellant, CLYDE L. STROUP, respectfully petitions this court for a rehearing in banc, pursuant to Rule 16 of the Practice Rules of the United States Court of Appeals for the Seventh Circuit, of this court's judgment and opinion entered by the court on the 25th day of August, 1981, on the ground that this court, in said judgment and opinion, overlooked and misapprehended the state of the record and the applicable rules of law pertaining thereto; that the subject appeal is of exceptional importance, and that the court's opinion is at variance with decisions of the United States Supreme Court and other courts of appeal; and that in support hereof, the defendant-appellant represents as follows:

1. That the rulings of this court concerning conspiratorial responsibility of the defendant-appellant are contrary to the law established in *Sunstrand Corp.* vs. *Sun Chemical Corp.*, 533

F2d 1033 (7th Cir. 1977); depart from the requisite intent requirements in Rule 10(b)-5 cases established in *Johns Hopkins University* vs. *Hutton*, 488 F 2d 912, cert. denied 416 U. S. 916, 94 S. Ct. 1622; and are in conflict with the rule established in *Blue* vs. *United States*, 148 F 2d 351 (6th Cir. 1943); that should this court's rulings and opinion be allowed to stand, it would establish dangerous new precedent in this jurisdiction creating unlimited vicarious liability in Rule 10(b)-5 cases and open the flood gates of litigation among unhappy investors and failed investment organizations.

2. That an award of damages for Dr. Chadbourn was unsupported by any evidence in the record of trial; that such issue could not have been submitted to a jury since the threshhold burden of presenting "some evidence" had not been met by Dr. Chadbourn; that this court's decision is contrary to the rule established in *Medigroup* vs. *Schildknecht*, et al., 463 F 2d 525 (7th Cir. 1972) requiring a plaintiff to show that he has actually sustained a loss before he can actually recover damages; and that this courts rulings and opinion is contrary to *Alover Distributors, Inc.* vs. *Kroger*, 513 F 2d 1137 (7th Cir. 1975).

3. That the court's interpretation of Federal Rules of Evidence, Rule 801(d)(2) is contrary to the mandates of the United Supreme Court as set down in *Krulewitch* vs. *United States*, 336 U. S. 440, 69 S. Ct. 716, 93 L.Ed.2d 790 (1949) and overlooks the foundational requirements for the admission of conspiratorial evidence; that this court's interpretation of such evidentiary requirements would establish new precedent in this jurisdiction running contrary to the law established in the Courts of Appeal in other United States Circuits in cases heretofore cited by defendant-appellant.

For the reasons stated, the defendant-appellant respectfully petitions this court for a rehearing in banc of this cause.

Respectfully submitted,

/s/ EDGAR A. BLUMENFELD, LTD.
Attorneys for defendant-
Appellant.

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Attorneys for defendant-appellant.

APPENDIX C

United States Court of Appeals

For the Seventh Circuit
Chicago, Illinois 60604
September 23, 1981

Before

Hon. WALTER J. CUMMINGS, Chief Judge
Hon. WILBUR F. PELL, JR., Circuit Judge
Hon. EARL R. LARSON, Senior District Judge*

FRANCIS C. TUCKER and CHARLES R. CHADBOURN,
Plaintiffs-Appellees,

No. 80-2155 *vs.*

CLYDE L. STROUP,
Defendant-Appellant.

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division.

No. 75 C 2931

Bernard M. Decker, Judge.

ORDER

On consideration of the petition for rehearing and suggestion for rehearing *en banc* filed in the above-entitled cause by defendant-appellant Clyde L. Stroup, no judge in active service has requested a vote thereon, and all of the judges on the original panel have voted to deny a rehearing. Accordingly,

IT IS ORDERED that the aforesaid petition for rehearing be, and the same is hereby, DENIED.

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* The Honorable Earl R. Larson, Senior Judge of the District of Minnesota, is sitting by designation.

APPENDIX D

STATUTES INVOLVED

Title 15 U.S.C., Section 77(1), Civil liabilities arising in connection with prospectuses and communications

Any person who—

(1) offers or sells a security in violation of Section 77(e) of this title, or

(2) offers or sells a security (whether or not exempted by the provisions of Section 77(c) of this title, other than Paragraph (2) of Subsection (a) of said Section), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission.

shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any Court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security. May 27, 1938, c. 38 Title I, Section 12, 48 Stat. 84; Aug. 10, 1954, c. 667, Title I, Section 9, 68 Stat. 686.

Title 15, U.S.C., Section 77(q), Fraudulent interstate transactions

(a) It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—

(1) to employ any device, scheme, or artifice to defraud, or

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

limited for acceptance thereof, and shall contain such further information, if any, as the Secretary of State may prescribe. Any agreement not to accept or refusing or waiving any such offer made during or prior to said 15 days shall be void.

D. No action shall be brought for relief under this Section or upon or because of any of the matters for which relief is granted by this Section after 3 years from the date of sale.

E. The term purchaser as used in this Section shall include the personal representative or representatives of the purchaser.

F. In addition to all other remedies, the Secretary of State through the Office of the Attorney General may bring an action in any circuit court of the State of Illinois in the name and on behalf of the State of Illinois against any person or persons participating in or about to participate in a violation of this Act to enjoin those persons who are continuing or doing any act in violation of this Act or to enforce compliance with this Act. Upon a proper showing the court shall grant a permanent or preliminary injunction or shall order rescission of any sales, tenders for sale, purchase or tenders for purchases of equity securities determined to be unlawful under this Act or order of the Secretary.

G. (1) Whenever any person has engaged or is about to engage in any act or practice constituting a violation of this Act, any party in interest may bring an action in the circuit court of the county in which the party in interest resides, or where the person has its principal office or registered office or where any part of the transaction has or will take place, to enjoin that person from continuing or doing any act in violation of or to enforce compliance with this Act. Upon a proper showing, the court shall grant a permanent or preliminary injunction or temporary restraining order, rescission of any sales, tenders for sale, purchases, or tenders for purchase of equity securities determined to be unlawful under this Act.

(2) A copy of the complaint must be served upon the Office of the Secretary of State within 24 hours of filing. This may be done by personal service or certified mail. Amended by P. A. 80-556, Section 1, eff. Sept. 8, 1977.

Title 15 U. S. C., Section 78(j), Manipulative and deceptive devices.

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

(a) To effect a short sale, or to use or employ any stop-loss order in connection with the purchase or sale, of any security registered on a national securities exchange, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of

such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

June 6, 1934, c/ 404, Title I, Section 10, 48 Stat. 891.

APPENDIX E

United States Constitution—Amendment V

No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offense to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.

United States Constitution—Amendment VI

In all criminal prosecutions, the accused shall enjoy the right to a speedy and public trial, by an impartial jury of the state and district wherein the crime shall have been committed, which district shall have been previously ascertained by law, and to be informed of the nature and cause of the accusation; to be confronted with the witnesses against him; to have compulsory process for obtaining witnesses in his favor, and to have the Assistance of Counsel for his defence.

United States Constitution—Amendment XIV

Section 1. All persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States and of the State wherein they reside. No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law, nor deny to any person within its jurisdiction the equal protection of the laws.

APPENDIX F

Securities and Exchange Commission, Rule 10B-5:

"Employment of manipulative and deceptive devices.

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

"(a) To employ any device, scheme, or artifice to defraud,

"(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

"(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

"in connection with the purchase or sale of any security."

Opposition

81-1160

No. 80-2155

Office - Supreme Court, U.S.
FILED
JAN 20 1982
ALEXANDER L. STEVAS,
CLERK

In the

Supreme Court of the United States

CLYDE L. STROUP,

Petitioner,

vs.

FRANCIS C. TUCKER and
CHARLES R. CHADBOURN,

Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR RESPONDENTS IN OPPOSITION

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QUESTIONS PRESENTED

1. Was there sufficient evidence to support the jury's finding that Stroup engaged in a general conspiracy to sell plaintiffs a series of limited partnership interests in real estate development project by fraudulent means, in violation of Section 10 of the Security Exchange Act and Rule 10b-5 of the Security Exchange Commission, where the evidence discloses that Stroup knowingly participated in a plan involving the following activity:

(a) the misrepresentation of Stroup's sales corporation as a "financial advisor;"

(b) the compilation of client data and the preparation of client dossiers as an artifice to induce "clients" to invest in tax shelters;

(c) the sales of virtually every investment with the false assurance of the same benefit, i.e., the same specific return and the same specific tax write-off;

(d) the nondisclosure of the risks of the investments;

(e) the arrangement of investment loans as a manipulative device to induce the investments;

(f) nondisclosure of the recipients of project fees and commissions, as well as information of the true value of the investments; and

(g) the creation of an investment program requiring clients to reinvest their funds from one project to another.

2. Does the record contain evidence to support the jury's findings that Stroup failed to withdraw the conspiracy where Stroup's only claim was that he resigned from the sales corporation and no evidence was adduced

to show that he took any affirmative act to disavow or defeat the original object of the conspiracy?

3. Whether this court should set aside the jury's award of damages on the grounds that plaintiffs failed to establish with absolute certainty that their investments are now worthless, where positive testimony was presented by one of the plaintiffs that all the investments projects were no longer in existence, where Stroup conceded to the trial court that plaintiffs had adduced evidence that the investments were worthless, and where he failed to rebut plaintiff's evidence?

4. Whether prejudicial error was committed by the admission into evidence over a hearsay objection of the testimony of plaintiff with one of Stroup's co-conspirators and certain testimony by one of Stroup's co-conspirators as to which he did not object?

PARTIES

Respondent has ignored the purpose of Rule 34(1) (b). Instead of providing the Court with a list of parties and related entities, he has set forth an irrelevant discussion of the settlements with other defendants which preceeded the trial and, the default judgment which was entered against certain defendants by the District Court after the trial. For that reason, Respondents set forth a brief statement of the specific nature of the proceedings below, as well as of the identity of the parties and related entities.

Petitioner seeks review of the decision of the United States Court of Appeals for the Seventh Circuit, affirming jury verdicts awarding Dr. Francis C. Tucker $115,-

000.00 and Dr. Charles R. Chadbourn $35,000.00 in a securities fraud and conspiracy case. Although the complaint was originally brought on behalf of multiple plaintiffs against multiple defendants, only the conspiracy and fraud claims of Drs. Tucker and Chadbourn against defendant Stroup were submitted to the jury.

At the time of trial, Dr. Tucker was a practicing pathologist in Freeport, Illinois, and was on the staff at the Freeport Memorial Hospital. Dr. Chadbourn was a retired practitioner of industrial medicine in Palos Heights, Illinois. During the pendency of Stroup's appeal, Dr. Chadbourn died, and the Palos Bank and Trust Company of Palos Heights, Illinois, has succeeded to his interests, as the Executor of his estate.

Petitioner Stroup is a practicing dentist, located in Chicago, Illinois. He was the initial president and a shareholder in Financial Profiles, Inc., a now defunct Illinois corporation. (Tr. 139)* Other relevant entities in which Dr. Stroup had an interest were: the Gallery Investment Trust, the general partner of the Gallery Limited Partnership, an Illinois Limited Partnership (Tr. 62-63, 74); Gallery International Corporation, a now defunct Illinois corporation (Tr. 85-89); Gallery Enterprises, Ltd. (Tr. 99).

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* The transcript of the proceeding in the District Court is cited as "Tr." other portions of the record in the Court of Appeals are cited as "C," and where appropriate by the document title, such as "Complaint, P."

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IN THE

SUPREME COURT OF THE UNITED STATES

No. 80-2155

CLYDE L. STROUP,

Petitioner,

vs.

FRANCIS C. TUCKER and
CHARLES R. CHADBOURN,

Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR RESPONDENTS IN OPPOSITION

OPINION BELOW

The Decision of the United States Court of Appeals for the Seventh Circuit was rendered in an unpublished order (App. A of Petition), issued pursuant to Circuit Court Rule 35 (U.S. Court of Appeals, Seventh Cir. Rule 35). The Court of Appeals' Order remains unpublished and is only listed in tabular form at 663 F.2d. 1077.

JURISDICTION

The jurisdictional requisites are adequately set forth in the Petition.

STATUTE AND REGULATION INVOLVED

The case was submitted to the jury under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78(j), and Rule 10b-5 of the Securities Exchange Commission, 17 C.F.R. §240.10b-5. These provisions are set forth in the Appendix to the Petition (App. D at 3d-4d; App. F).

STATEMENT OF THE CASE

A. The Pleadings

The allegations of plaintiffs' Amended Complaint are summarized in the opinion of the Court of Appeals. (App. at 2A-4A) Essentially, it charged that the defendants had entered into a deceptive and manipulative course of conduct in connection with the issuance, offer and sale of limited partnership interests in real estate projects which were created and managed by Financial Profiles, Inc., and sold by it to plaintiffs. (Complaint ¶16, 50, 51; C. 166-67, 186-87).

Drs. Tucker and Chadbourn were sold limited partnership interest in five real estate projects, as "tax shelters," by Financial Profiles. Dr. Tucker invested a total of $125,000.00 in all five projects. (Tr. 153-54) Dr. Chadbourn invested $35,000.00 in three of these projects. (Pl. Exs. 6-1 through 6-8) Their interests in each of these limited partnerships is now defunct, and no repayments were made to plaintiffs. (Tr. 139, 153-55)

B. The Participants in the Conspiracy

The evidence disclosed that Financial Profiles was composed of three "insiders":

Defendant Dr. Clyde L. Stroup —

He was a co-founder and 50% shareholder in Financial Profiles and its initial president. (Tr. 38-39) He was in charge of compiling its client information data (Tr. 232), and he authored a form of client dossier, known as a "Financial Profile," which was used to sell the limited partnerships interests. (Tr. 232) Along with the other insiders, he developed a scheme where "tax shelter" investments would be sold to clients on the basis of guaranteed returns and tax write-offs and whereby investors would be induced to perpetually reinvest from one tax shelter to another, in order to maintain these benefits. (Tr. 236-37, 262-65)

Defendant Lawrence J. Janota —

He founded Financial Profiles with defendant Stroup and was its other 50% shareholder. (Tr. 38-39) He was its initial vice president. Along with Stroup, he developed Financial Profiles' modus operandi. He and Stroup were responsible for the preparation of the prospectuses for a number of Financial Profiles' tax shelter projects. (Tr. 232-35)

Defendant Robert B. Miller —

He was the principal salesman for Financial Profiles. He was responsible for the collection of the client data and presentation of the "financial profile." (Tr. 232) Pursuant to Stroup's and Janota's instructions, he sold the tax shelters as investments presenting a 10% to 15% return and a 60% to 70% tax write-off. (Tr. 236-37)

The amended complaint also named several "outside" conspirators, including two Chicago banks. Substantial evidence was introduced at trial as to the activities of only one outsider:

Defendant Cornelius Pitt —

He was Financial Profiles' attorney. (Tr. 314) He was the beneficial owner of the Alexandrian Investment Trust, an entity which owned 50% of the Gallery Limited Partnership. (Tr. 74) He was paid an undisclosed fee out of the funds raised from the limited partnership investors. (Tr. 84, 314) He assisted Stroup and Janota in the preparation of the prospectus for the Gallery Limited Partnership, as well as other tax shelters sold to Financial Profiles' clients. (Tr. 232-35, 319)

C. The Formation of Financial Profiles

Financial Profiles was formed by Dr. Stroup and Lawrence Janota in February 1971. (Tr. 38) Each owned 50% of its stock. (Tr. 39) Upon its formation, Stroup became its president and Janota its vice-president. (Tr. 39)

Ostensibly, Financial Profiles was a financial consulting firm. (Tr. 226) It held itself out to physicians and professional people as a tax advisor and investment counselor. (Tr. 216, 241; Pl. Ex. 3-1) In reality, Stroup admitted, its purpose was simply to sell real estate investments. (Tr. 40)

Financial Profiles' initial real estate tax shelter was the Gallery Limited Partnership. (Tr. 226-27) Stroup recruited Mueller to work for Financial Profiles in February or March 1981 and immediately assigned him to selling interests in this Limited Partnership. (Tr. 226-27)

D. Financial Profiles' Modus Operandi

From the outset, Stroup, Janota and Mueller agreed on a plan of marketing their investments. This plan was used on virtually all Financial Profiles "clients." (Tr.

238) As part of this plan, Financial Profiles held itself out as a "Financial Advisor" (Tr. 240-41; Pl. Ex. 3-1) and prepared a financial dossier for its "clients". This dossier always recommended an investment in a real estate tax shelter. (Tr. 243-49)

Financial Profiles then offered to "put" the "client" in a tax shelter that would purportedly produce a return of 10% to 15% and a 60% tax write-off. The projected return and tax write-off were the same for every project, except that after 1971, the investments were sold on the basis of a 15% return rather than a 10% return. Mueller testified that it was fair to say that the promises of the 10% to 15% return and 60% tax write-off were the "sales tools" used to sell the investment. (Tr. 236-37)

Mueller testified, however, that Stroup, Janota and he recognized that these "sales tools" had certain drawbacks. Write-offs could not continue to be taken against the investment, nor could the money be returned to the investor without a tax impact. Clients, therefore, had to perpetually reinvest their funds to maintain a tax shelter. (Tr. 265-66) Accordingly, Stroup, Janota and Mueller planned to create "new limited partnerships around old ones," so investors would be taken out of one investment and placed in another. At the time of this reinvestment, the doctor would also put his "return" from the initial investment and additional money in the new one. In other words, their plan was to create an investment program, so that the investor, as long as he had a tax problem, was going to have to purchase a tax shelter from Financial Profiles. (Tr. 264-65) In the sales presentation, the concept was explained in terms of a "snowball" effect, where the doctor's equity grew over a series of years, as his funds revolved from one tax shelter to another. (Tr. 122-24; 141-43; Pl. Ex. 29-16-A)

Mueller testified that another problem for the insiders was simply the question of financing. To facilitate sales and finance the investments, it was decided by Stroup, Janota and Mueller that loans had to be arranged for the doctors. Accordingly, in the spring of 1971, Financial Profiles made arrangements with the United of America Bank to make loans to its clients for the investments. A similar arrangement was made with the Michigan Avenue Bank in late 1981. (Tr. 227-29)

Mueller testified as to the precise manner in which these plans were carried out. When it initially contacted a doctor, it held itself as a "Financial Advisor." (Tr. 216, 239; Pl. Ex. 3-1) It offered to analyze the doctor's financial situation and collected data from him on his income, assets, expenses, insurance and investments. (Tr. 241-42)

This information was given to Stroup, who prepared a dossier for the prospective client, called a "financial profile." (Tr. 42-44) This booklet contained information on budgeting, tax shelters and leasing, together with personal financial statements of the client's assets, liabilities and cash flow. (See Pl. Ex. 29-5) All of the information, except the doctor's financial statements, was standard information, including the sections recommending investments in real estate tax shelters. (Tr. 43-44)

After the financial profile was completed, Stroup would meet with Mueller to discuss the "benefits" that would be sold to the doctor. On the Gallery Limited Partnership, for instance, these were a guaranteed annual return of 10% and the 60% tax write-off. (Tr. 244-45)

When the financial profile was presented to the doctor, they would go through it page by page. It would be pointed out, however, that the biggest item in the doctor's

financial picture was his taxes. (Tr. 247) The presentation was built to demonstrate that before the doctor met Financial Profiles, "he was taking his income and turning it into taxes."

It was suggested that Financial Profiles could find a tax shelter for the doctor. (Tr. 239) The presentation then shifted into a discussion of what Financial Profiles called, "O.P.M." the use of "other peoples money." (Tr. 250) Essentially, this entailed a discussion of borrowing the money for the investment either on the cash values of the doctor's life insurance, his office equipment, or through one of the banks with which Financial Profiles had an arrangement. (Tr. 250-51)

After this presentation, the sale of the investment quickly followed. Financial Profiles had the doctor sign an authorization to borrow on his life insurance or an application for a loan from the Michigan Avenue National Bank or the United of America Bank. (Tr. 120-121, 126-27, 129-30, 137-38)

The tax shelter was always presented to the doctors as providing a 10% to 15% return and a 60% write-off. (Tr. 122, 129, 131, 138, 236-37, 239, 273-74) A descriptive brochure of the particular project was also given to the doctors, but nothing was told to them about the risks associated with the projects. (Tr. 276) The brochures themselves also omitted any information risks of the investment, the identities of the general partners or trustees, the recipients of the development fees and charges, the capitalization of the project, the amount and nature of any debt and the compensation of the general partners, trustees or underwriter. (Pl. Exs. 31-10, 31-13, 31-17, 31-22; Tr. 65, 152-53)

During the sales presentation, the doctor was also exposed to the idea of equity growth. He was told how in subsequent years he could reinvest the funds he was placing in the initial investment and the return from the investment in more tax shelters. He was told that his equity would increase over a period of time, like a rolling snowball. (Tr. 122-23, 143; Pl. Ex. 31-16-A)

E. The Gallery Limited Partnership Transaction

The Gallery Limited Partnership was Financial Profiles' first tax shelter and the first one in which Drs. Tucker and Chadbourn invested. (Tr. 226-27) The project involved a plan to convert the old historical society building in Chicago to a private nightclub which would be similar to a Playboy Club. (Tr. 58, 226-27)

The property was owned by an entity called the Factory, Inc., (Tr. 67-69) Stroup, Janota and Pitt decided to buy the property from the Factory corporation and form the Gallery Limited Partnership to finance the enterprise. (Tr. 75)

The evidence disclosed a series of machinations by the Financial Profile insiders:

(1) Secret Self-dealing By Principals

To purchase the property, Stroup, Janota and Pitt formed the Gallery Investment Trust, as well as the Gallery Limited Partnership. Stroup and Janota each owned 25% of the Gallery Investment Trust. The remaining 50% of the Trust was owned by an entity known as the Alexandrian Investment Trust, which was owned and controlled by defendant Pitt. (Tr. 69, 74-75)

When Stroup and Janota formed the Gallery Limited Partnership, The Gallery Investment Trust became the

general partner and received a 50% interest in the Partnership. (Tr. 55-56) The Factory corporation also received a 12 ½% interest in the Limited Partnership. (Tr. 56) The remaining 37 ½% interest was sold through Financial Profiles to investors for a total sum of $333,000. (Tr. 56-57; 82)

The insiders also created Gallery International Corporation to lease the premises from the Gallery Limited Partnership and run the nightclub. (Tr. 86-87) Galleries International was organized and owned by four persons: Stroup, Janota, The Factory Corporation, and Gallery Enterprises, Ltd. (Tr. 85)

Investors were misinformed about the true ownership of the Gallery Investment Trust, the general partner and 50% owner in the Limited Partnership. The prospectus stated that the owner was Gallery Enterprises Corporation, whose owners were not identified. Stroup admitted this was a misrepresentation. (Tr. 80-81, 91); the investors were never informed that he, Janota and Pitt's Alexandrian Investment Trust were the real owners of the Gallery Investment Trust. (Tr. 92-93) Similarly, the investors were never informed that the principal shareholders of Galleries International, the purported leasee of the Building, were Stroup and Janota. (Tr. 124-25)

(2) Secret Profits By The Principals

The Gallery Investment Trust, through Stroup, contracted to buy the building from the Factory in February 1971. (Tr. 69) Although the contract provided a purchase price of $1,040,000, the amount actually paid by the Gallery Investment Trust to the Factory was only $50,000. (Tr. 70-73, 100-01)

Prior to the acceptance of the investor limited partners, the Gallery Investment Trust "resold" the property to the Gallery Limited Partnership for $1,450,000. (Tr. 76-77) The Gallery Investment Trust received a gross profit of $695,131 from the sale. (Tr. 78) It also retained its 50% interest in the Limited Partnership. (Tr. 77)

The $695,131 profit realized by the Gallery Investment Trust and its owners — Stroup, Janota and Pitt — was admittedly never disclosed to the investors in the Gallery Limited Partnership. (Tr. 79)

(3) The Secret Commissions of the Principal

The Gallery Investment Trust and the insiders also received substantial fees from the sale to the Limited Partnership. Of the $330,000 invested by the limited partners, a total of $231,000 was paid in various fees. (Tr. 82) The Gallery Investment Trust received a $126,000 fee. (Tr. 84) Financial Profiles received $49,500. (Tr. 82) Pitt, the attorney for Financial Profiles and owner of the Alexandrian Investment Trust, and Joseph Borenstein, the president of the Factory, also received fees. (Tr. 73, 83)

The prospectus failed to disclose this payment of $231,000 in fees to the insiders. (Tr. 82-85) This omission was never rectified by subsequent disclosures to investors.

(4) False Assurances of 10% Return

The limited partnership interests in the Gallery Limited Partnership were sold on the basis of a promise of a guaranteed annual return and a tax write-off. It was orally presented to investors as providing them a 10% annual return and a 60% to 70% tax write-off. (Tr. 117-18, 122, 165, 198, 236-37, 238-39)

The prospectus also specifically assured investors that the Gallery Limited Partnership was a safe investment, and would provide a 10% annual return. This guaranteed annual return was premised on a lease with Galleries International. (Tr. 86-87; Pl. Ex. 31-10 at p. 5)

While the descriptive brochure stated that the Galleries International's lease assured investors a 10% return, in fact, Galleries International was never activated, and no assets were ever contributed to the Corporation. (Tr. 86) Nothing was disclosed in the prospectus about these facts. (Tr. 88-89) Indeed, as Stroup admitted, the prospectus did not even disclose that the 10% return might not be assured. (Tr. 89)

F. Plaintiffs' Subsequent Investments

(1) The Riviera Project

As soon as Dr. Tucker signed the Gallery Limited Partnership Agreement, Mueller recommended that he get into some additional tax shelter investments. Mueller told Tucker: that this would permit him to take additional tax write-offs, that money was available through loans at banks with which Financial Profile had an arrangement, and that his initial investment would "snowball" into additional equity. (Tr. 123-24)

Mueller recommended to Tucker that he make another investment of $10,000 in the Condominium Trust of America, the Riviera project. (Tr. 126) Although Tucker had no immediate funds, Mueller told him that he could arrange a loan for him, as he had for other physicians, through the Michigan Avenue National Bank. (Tr. 126-27) Tucker took Mueller's advice and invested $10,000 in the Riviera project. (Tr. 129; Pl. Ex. 29-13, 29-14) This sale was consummated before Stroup got out of

Financial Profiles and the Gallery Investment Trust on April 30, 1972. (Tr. 89, 329-30)

In selling the Riviera investment, Mueller followed the same procedure as he had with the Gallery investment. He promised a 10% annual return and a 60% tax write-off. (Tr. 129, 273) The prospectus for the project presented the same return, but omitted any information on the risk, the recipients of devlopment fees, the identities of the trustees, the capitalization of the project, the amount and nature of any debt, and the compensation of the trustee. (Pl. Ex. 31-17)

(2) The Palmer Court Project

In February 1972, Mueller sold Tucker still another investment, an interest in the Palmer Court Condominium Trust. (Tr. 130) Dr. Tucker invested $50,000 in the Palmer Court project which he financed wtih a $40,000 loan from Michigan Avenue National Bank and $10,000 of his personal funds. (Tr. 130, Pl. Exs. 29-21) The loan bore a 10% interest rate, but Mueller explained that the return on the project would be 15%. (Tr. 130-31) Dr. Chadbourn made a similar investment of $10,000 in the Palmer Court project in March 1972. (Tr. 221; Pl. Exs. 6-3, 6-4, 6-5) Again, these sales were consummated before Stroup "withdrew" from his arrangement with Janota on April 30, 1972. (Tr. 89, 329-30)

Although Financial Profiles gave investors a prospectus for the project (Tr. 130-32; Pl. Ex. 31-13), Mueller testified that it followed the same procedures in selling the Palmer Court investment as with the Gallery project. The "sales tools" were a 60% tax write-off and a promised annual return. The only difference was the Financial Profiles promised investors a 15% return, rather than a 10%. (Tr. 274) Again the prospectus presented the

same return, but omitted anything on the risk, the identities of the trustees, the capitalization, the debst structure, and the recipients of the development fees. (Pl. Ex. 31-13)

(3) The Wheeling Project

In December 1972, Dr. Tucker invested $10,000 in the Wheeling Condominium Trust. (Tr. 134-35) As before, it was sold to him on the basis of a 15% annual return and 60% tax write-off. (Tr. 275) The prospectus did not disclose, however, the owners of the general partner, who received the development commissions, the project capitalization or indebtedness, or the compensation of the general partner. (Pl. Ex. 13-22)

(4) The Bradenton Project

In December 1972, Tucker was informed by Financial Profiles that the Palmer Court project had paid off. Mueller suggested making another investment using the $50,000 which Tucker had invested in the Palmer Court project and an additional $25,000, which could be financed by a loan. (Tr. 136-37) Although Dr. Tucker initially balked at the suggestion (Tr. 137), he eventually agreed to the transfer. His original investment of $50,000, plus his purported return of 15% on the Palmer Court project were transferred to the Bradenton project and he invested an additional $25,000 in Bradenton from the proceeds of the loan by the United of America Bank. (Tr. 138, 275; Pl. Ex. 31-4) Dr. Chadbourn, likewise, invested $15,000 in the Bradenton Limited Partnership in December 1973. (Pl. Ex. 6-6, 6-7, 6-8)

The transfers from Palmer Court to Bradenton were nothing more than paper transactions. Mueller explained

that the Palmer Court project ran into both construction and financial difficulties. There was no money to Drs. Tucker and Chadbourn, or other investors. Consequently, Financial Profiles simply "traded" the investments in the Palmer Court project, putting them into the Bradenton project. Drs. Tucker and Chadbourn, of course, were never told there was really no money left in Palmer Court. (Tr. 277-78)

G. Stroup's Continuing Relationship With Financial Profiles

Stroup testified that he resigned from Financial Profiles on November 22, 1971. However, it is unclear when Stroup's resignation from Financial Profiles was actually consummated. While his resignation was dated November 22, 1971, Stroup admitted that it was not scheduled until after the closing of the Gallery Limited Partnership in December 1971. (Tr. 328) He did not recall why the resignation was predated. (Tr. 328)

According to Mueller, Stroup's resignation from Financial Profiles wasn't formalized until March 1972. (Tr. 235) Even under Stroup's own version, he didn't "get out" of Financial Profiles and the Gallery Limited Partnership until he made a new arrangement with Janota, where he traded his interest in the Gallery Investment Trust to Gallery Enterprises on April 30, 1972. (Tr. 89, 99, 329-30)

Stroup admitted the procedures subsequently followed by Financial Profiles were established by Janota and him, before he left the Corporation. (Tr. 98) These included the solicitation of client data, preparation of the client dossiers and the form and substance of the sales presentation to doctors about the "benefits" of tax shelters. (Tr. 98-99) These benefits, of course, included the promise of a guaranteed annual return and a tax write-

off, "which were the sales tools" used on Financial Profiles' clients. (Tr. 236-37)

Stroup admitted that he knew, when he left Fnancial Profiles, that it was going to continue with these activities. (Tr. 99) He left with Financial Profiles' materials that he had compiled and authored for its sales program, including the magnetic cards for the dossier and the client information about individual investors. (Tr. 96-97) Indeed, before resigning from Financial Profiles, Stroup made an agreement with Janota that they would both have access to the client data and the other materials. (Tr. 97-98)

Moreover, Stroup's resignation from Financial Profiles was based on a series of other agreements with Janota. He traded his investment in Gallery Investment Trust for 100,000 shares of the stock of Gallery Enterprises. (Tr. 89, 99) Under this arrangement, Stroup became the Chairman of the Board of Directors of Gallery Enterprises. (Tr. 99) It was also agreed that Financial Profiles would raise $150,000 in capital for Gallery Enterprises. (Tr. 99)

Through Gallery Enterprises, Stroup continued to work with Janota to maintain the appearance that Gallery Limited Partnership was a viable investment, which produced the promised, 10% annual return. For instance, Dr. Tucker received several checks from Financial Profiles for his return on the investment. (Tr. 205) Mueller, however, explained that in order for Financial Profiles to maintain its credibility with the initial investors and to be able to sell them further investments, it had to produce the 10% return, even though the Gallery Limited Partnership was unable to pay the return. So, Janota made arrangements with Stroup and the Gallery.

for Financial Profiles to make the dividend payments and to be paid back later. (Tr. 256-60; Pl. Ex. 29-59)

Ultimately, the financial troubles of Gallery Enterprises and the Gallery Limited Partnership could no longer be covered up. When this occurred in 1974, Stroup sent various reports to the investors and solicited their proxies. (Tr. 93-94; Pl. Exs. 79-13, 79-14) Of course, in these reports Stroup did not disclose such things as the Gallery Investment Trust's $695,000 profit on the resale of property, nor the failure to consummate the promised lease with Galleries International. (Tr. 94-95) The reports, however, served their purpose; for instance, Stroup successfully solicited Dr. Tucker's proxy from him. (Tr. 96)

H. Plaintiffs' Injuries

Financial Profiles is no longer doing business. (Tr. 139) Each of the projects which Drs. Tucker and Chadbourn invested are no longer in existence. (Tr. 139) The Gallery Limited Partnership went bankrupt, and the property sold for delinquent taxes. (Tr. 67) The Palmer Court project, as pointed out by Mueller, went broke and paper transfers made of the invested funds to the Bradenton project. (Tr. 277-78)

Dr. Tucker specifically testified that each of the projects are now worthless. (Tr. 154-55) It was also conceded by Stroup's counsel to the District Court at trial that neither Drs. Tucker or Chadbourn received any money back from the investments and that each was worthless. (Tr. 185) In short, Drs. Tucker's and Chadbourn's losses were undisputed. (Tr. 147-48)

SUMMARY ARGUMENT

Stroup asks this Court to entertain a repetition of his appeal to the Court of Appeals. Essentially, he claims that the evidence was insufficient to support the jury's verdict.

The Court of Appeals, of course, conducted a complete review of the proceedings in District Court. In sustaining the jury verdict, the Court of Appeals rejected the same contentions that Stroup raises here. It found that the evidence supported the jury's finding of Stroup's culpability for a general conspiracy to defraud plaintiffs, specifically pointing out: "as Defendant Mueller explained, the original conspiracy included such further deals as were made with plaintiffs, thus binding Stroup as to them." (App. at 6a) It found that the jury was properly instructed that Stroup could not prove withdrawal from the conspiracy unless he showed that "he took some affirmative action to disavow or defeat the purpose of the conspiracy" and that the jury's finding that Stroup had not withdrawn from the conspiracy "was justified by the evidence." (App. at 6a) It found that the District Judge "was . . . extremely careful in instructing the jury on the requirements of *scienter*" and that "there was sufficient evidence to support his culpability under the scienter of reckless disregard standards." (App. at 6a-7a) It found that Stroup's claim "that the jury's award of damages to plaintiff was unsupported is without merit." (App. at 7a) Finally, it rejected Stroup's evidentiary contentions, finding that one of the conversations at issue was not hearsay and that no objections had been made to the introduction of the other. (App. at 9-10)

The Court of Appeals' conclusions were based on well-established principals of law, and were manifestly correct. This is certainly not the case which warrants invocation of this Court's supervisory powers.

Nor is it a case which creates a conflicting precedent with other appellate decisions. Indeed, Stroup's arguments are premised primarily on authorities of the Seventh Circuit from which he believes the Court of Appeals has made a departure. In any event, this case was decided by the Court of Appeals pursuant to an unpublished Order under Circuit Rule 35.

ARGUMENT

I.

THERE WAS SUBSTANTIAL EVIDENCE FROM WHICH A JURY COULD CONCLUDE THAT STROUP PARTICIPATED, WITH THE REQUISITE SCIENTER, IN A GENERAL CONSPIRACY TO FRAUDULENTLY SELL TAX SHELTERS.

A. The Scope of the Conspiracy

The Court of Appeals found Stroup culpable of misrepresentations and omissions in six areas with respect to the Gallery Limited Partnership. (App. at 5) While Stroup now concedes liability for the Gallery project, he seeks to escape responsibility for plaintiffs' investments in subsequent tax shelters.

Stroup's contentions ignore the fact that the Gallery Limited Partnership was but a microcosm of a broader scheme between the Financial Profiles insiders. Plaintiffs' evidence established that Stroup and the other insiders embarked on a conspiracy to fraudulently sell a series of tax shelters to Financial Profiles' "clients." This conspiracy commenced at the time of the formation of the Corporation and continued until the collapse of the scheme. It encompassed the following activities:

(1) The misrepresentation of Financial Profiles as a "financial advisor;"

(2) The compilation of client data and the preparation of client dossiers, "financial profiles," as an artifice to induce Financial Profiles' "clients" to invest in tax shelters;

(3) The sale of virtually every tax shelter with the assurance of the same benefit, i.e., the same specific return and the same specific tax write-off;

(4) The distribution of prospectuses with respect to each project which failed to disclose the attendant risk of the investments;

(5) The inducement of sales through the arrangement of loans to finance the investment, i.e., the selling of the use of "other peoples' money"

(6) Non-disclosure and project prospectuses of the recipients of project fees and commission; and

(7) The creation of an investment program which required "clients" to perpetually invest and reinvest their funds from one of Financial Profiles' tax shelters to another.

B. The Illegal Acts, Knowingly Committed In Furtherance of the Conspiracy

Whether considered individually or in the aggregate, it is clear that these activities constituted an unlawful scheme, artifice, contrivance, act practice or course of conduct to defraud, deceive or manipulate buyers of securities in violation of Section 10b of the Securities Exchange Act of 1934 and Rule 10b-5. Moreover, it is clear that Stroup participated in the instigation of each of these activities by Financial Profiles, and that he is, therefore, culpable under the standards articulated by this Court in *Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185 (1976) and by the Seventh Circuit in *Sanders* v. *John Nuveen & Co.,* 554 F.2d 790, 791-94 (7th Cir. 1977); *Sunstrand Corp.* v. *Sun Chemical Corp.,* 554 F.2d 1033, 1043-45 (7th Cir. 1977).

(1) The Fraudulent Representation of Financial Profiles as a Financial Adviser

Financial Profiles solicited its clients by holding itself out as a "financial advisor", but the real purpose of Financial Profiles was to sell tax shelters. (Tr. 40) As a purported financial advisor, it accumulated data on each of its clients and prepared the dossier for each of them with a financial analysis and recommendations. Stroup was the author of these dossiers, and each dossier recommended an investment in a real estate tax shelter, regardless of the client's financial circumstances. In reality, Stroup and Financial Profiles were engaged in nothing more than a charade when they held themselves out as financial advisors. This was demonstrated graphically to the jury, when Stroup admitted that he was not qualified to render an opinion on what kind of asset base was necessary to sustain one of the investments. (Tr. 350)

In short, Stroup and the other insiders had neither the intent, nor the expertise to properly act as plaintiffs' "financial advisors." As the Court of Appeals found (App. at 5a), the offering of such purported expert counsel without the basis of such advice supports liability under Rule 10b-5. *E.g., Gottreich* v. *San Francisco Investment Corp.*, 552 F.2d 866, 867 (9th Cir. 1977); *Franklin Savings Bank* v. *Levy*, 551 F.2d 521, 527 (2nd Cir. 1977).

(2) The False Assurance Of A Specific Return On The Investment

Each of the tax shelters were sold by Financial Profiles on the basis of the same benefits. These benefits were the promise of a guaranteed annual return of 10%

to 15% and a tax write-off of 60%. These benefits were promised investors not only on the Gallery project but all of Financial Profiles' subsequent investments, including the Riviera project, the Palmer Court project, the Wheeling project, and the Bradenton project. (Tr. 236-37, 273, 275). These representations were not only oral, but in the project prospectuses. (Pl. Exs. 31-13, 31-17, 31-22)

Mueller described the promises of these annual returns and tax write-offs as the "sales tools" that Stroup, Janota and he had agreed to use on Financial Profiles' clients. (Tr. 236-37) Mueller also testified as to how Stroup would meet with him to discuss the "sale" of these benefits. (Tr. 244-45).

Needless to say, representation of the 10% return and 60% tax write-offs are material representations. Certainly, it bears little elaboration that such assurances are entirely illusory where they are used simply as "sales tools". *E.g., S.E.C.* v. *Haffenden-Rimar International, Inc.*, 362 F. Supp. 323 (E.D. Va. 1973), *aff'd.*, 496 F.2d 1192 (4th Cir. 1974); *Lerman* v. *Tenney*, 295 F.Supp. 780, 782 (S.D.N.Y. 1969). The Court of Appeals properly found these representations to violate Section 10 of the Security Exchange Act and Rule 10b-5. (App. at 5a)

(3) The Nondisclosure Of Investment Risk; Development Fees Or Other Material Information

The Financial Profile insiders prepared and gave clients prospectuses on the tax shelter investments. Nothing, however, was told clients about the risk associated with the projects. (Tr. 276) Stroup prepared the prospectus for the Gallery project and other tax shelters offered by Financial Profiles in 1971 and early

1972. (Tr. 233-35) The prospectuses for subsequent investments essentially followed the format of the one for the Gallery project.

These prospectuses omitted the recipients of the development fees. They also omitted any information concerning the risks of the investment, the identity of the general partners or trustees, the capitalization of the project, the amount and nature of any debt and the compensation of the general partners, trustees or underwriter. (Pl. Exs. 31-10, 31-13, 31-17, 31-22) In short, it was absolutely impossible to determine the risk or true value of the investments.

Again, it bears little elaboration that prospectuses which fail to discuss risks are materially misleading. *See, e.g., Blakely* v. *Lisac,* 357 F.Supp. 255, 262 (D. Ore. 1972); *Lerman* v. *Tenney,* 295 F.Supp. 780, 783 (S.D.N.Y. 1969). Likewise, nondisclosure of the true value of an investment constitutes a violation of Rule 10b-5. *E.g., S.E.C.* v. *Charles A. Morris & Assoc., Inc.,* 386 F.Supp. 1327, 1334 (W.D. Tenn. 1973).

(4) The Arrangement Of Loans As A Manipulative Device

To facilitate the sale of the tax shelter investments, it was agreed by Stroup, Janota and Mueller that loans would be arranged for the doctors. While Stroup was still president of Financial Profiles, he made arrangements with the United of America Bank and Michigan Avenue Bank to make loans to its clients for the investments. (Tr. 277-29) Financial Profiles, of course, could not lawfully arrange such loans with either bank under Regulation T, 12 C.F.R. §220.7(a). *E.g., Shull* v. *Dain, Kalman & Quail, Inc.,* 561 F.2d 152, 160-61 (8th Cir. 1977); *Pargas, Inc.* v. *Empire Gas Corp.,* 423 F.Supp. 199, 236, 240

(D.Md. 1976); *Alaska Interstate Co.* v. *McMillen*, 402 F.Supp. 532, 554-56 (D.Del. 1975).

However, regardless of whether an independent cause of action exists on this ground alone, the arrangement of the loan with the Banks served as a manipulative device whereby Financial Profiles induced doctors to invest in its tax shelters, without an assessment of the inherent risk of the investments. Certainly, the arrangements which Financial Profiles established with the Banks were a proximate cause of Dr. Tucker's investments after the Gallery project.

(5) The Rolling Over Of The Investments

Finally, there is the fact that the plan concocted by Stroup, Janota and Mueller contemplated continuous investments by Financial Profiles' clients in a series of tax shelters. This was presented to the doctors simply in terms of a growth of their equity as their funds revolved from one tax shelter to another, without any disclosure of the attendant risk or the commissions which would be received by Financial Profiles.

In reality, the investment program functioned like a Ponzi scheme, as when Financial Profiles issued the checks for the investors returns in the Gallery project and when the Palmer Court project went broke, but plaintiffs were told it had paid-off and induced to reinvest the funds and additional money in the Bradenton project. Stroup of course, knew these machinations, both generally, because he had originally planned with Janota to create "new limited partnerships around old ones," and specifically, because he participated in the arrangements for Financial Profiles to make the dividend payments to the investors in the Gallery project to cover up its own lack of funds. (Tr. 256-60, 264-65)

C. The Jury Was Properly Instructed

Stroup, of course, argues that the broad scheme which he authored should be ignored and the circumstances of each of plaintiffs' investments should be considered in a capsulized form, as a separate and independent conspiracy, in determining his culpability. This argument, however, presents a jury question as to the scope of the conspiracy, which the jury resolved against him.

It should be noted, moreover, that the jury was fully instructed on the necessary legal requirements. It is instructed on the requirement of *scienter* (C. 1367A, 1370-71; Tr. 460-62), on aiding and abetting liability (C. 1377-78; Tr. 464-65), on the prerequisites of a conspiracy (C. 1379-82; Tr. 469-73), and the liability of co-conspirators (C. 1383-86; Tr. 473-76).

II.

THERE WAS SUFFICIENT EVIDENCE FROM WHICH A JURY COULD CONCLUDE THAT STROUP FAILED TO WITHDRAW FROM THE CONSPIRACY.

Stroup attempts to absolve himself of responsibility for anything atfer Gallery on another ground, — the claim that he was out of the conspiracy before plaintiffs' other investments. This contention is simply at odds with the evidence.

Stroup did not "get out", even under his own version of the circumstances, until he made a new deal with Janota and he traded his interest in the Gallery Investment Trust to Gallery Enterprises on April 30, 1972. Thus, Stroup did not "withdraw" until after Dr. Tucker had invested an additional $10,000 in the Riviera project and another $50,000 in the Palmer Court project. Dr. Chadbourn also invested $10,000 in the Palmer Court project before Stroup's "withdrawal".

In any event, Stroup's naked protestations that he had nothing to do with Financial Profiles after the Gallery transaction are insufficient to constitute a withdrawal. Once plaintiffs had established the conspiracy to violate the Federal Securities Law, and Stroup's participation in it, the burden shifted to him to show that he withdrew from the conspiracy. He could not escape liability for the acts and declarations of his co-conspirators unless he established that he withdrew from the conspiracy by some affirmative act to disavow or defeat the purpose of the conspiracy. *Blue* v. *United States,* 148 F.2d 351, 260 (6th Cir. 1974), cert. denied, 322 U.S. 736 (1934). *Accord, Herpich* v. *Wilder,* 430 F.2d 818 (5th Cir.) *cert. denied,* 401 U.S. 947 (1970); *Dasho* v. *Susquenna Corp.,* 380 F.2d 262, 267 2d (7th Cir.) *cert. denied,* 389 U.S. 977 (1967).

The overwhelming evidence demonstrates that not only did Stroup fail to show any act by him which disavowed or defeated the object of the conspiracy, but he purposely engaged in a continuation of the conspiracy by concealment of the fraud, and by leaving Financial Profiles his contribution to the scheme. *E.g., United States* v. *Gonzalez-Carta,* 419 F.2d 548, 661 (2d Cir. 1969). *See, also, United States* v. *Cullen,* 499 F.2d 545, 547 (9th Cir. 1974); *Eldredge* v. *United States,* 62 F.2d 449, 451 (10th Cir. 1932). *See, generally, Bromberg Securities Law: Fraud S.E.C. Rule 10b-5* ¶¶8.5(540)-(549).

He admitted that the procedures for Financial Profiles' sale of tax shelters had been established prior to his departure and that he knew Financial Profiles was going to continue to market tax shelters in the same manner. (Tr. 98-99) During the time he was president of Financial Profiles, he took substantial steps to insure the success of its sales program, including the preparation of

the form of client dossier recommending tax shelters, which was maintained on magnetic cards to facilitate the production of apparent originals. Stroup left these materials with Financial Profiles when he resigned. (Tr. 96-97) In addition, upon leaving, Stroup obtained an agreement from Janota that he could use the personal financial data received from Financial Profiles' clients to pursue further sales to them to tax shelters. (Tr. 97-98)

Moreover, Stroup never advised plaintiffs of his resignation from Financial Profiles (Tr. 99), even though he had made these agreements with Janota on the sale of tax shelters, had contact with various Financial Profiles clients and had his name on Financial Profiles materials. However, when it became obvious that Gallery Enterprises and the Gallery Limited Partnership were on the verge of financial collapse in 1974, Stroup finally sent reports to the investors. This simply a ploy to divert any blame for the failure of the investments from himself. His reports, of course, never disclosed the initial circumstances of the transaction.

Finally, there is Stroup's and Financial Profiles' concealment of the Gallery Limited Partnership fraud, so that the investors could be induced to make further tax shelter investments. (Tr. 256-58) Thus, during 1972 and 1973, investors were told the Partnership was doing very well (Tr. 272), and Financial Profiles sent dividend checks to them to cover up the project's lack of capital. (Tr. 258-60)

It is clear that Stroup's resignation from Financial Profiles standing alone, does not exonerate him from liability for investments made by plaintiffs after his resignation. At best, it presented a question for the jury, and the jury was fully instructed of the prerequisites of a withdrawal from the conspiracy, without objection by

Stroup as to the substance of the instruction. (Tr. 476-77; C. 1389)

III.

STROUP'S EVIDENTIARY OBJECTIONS WERE PROPERLY OVERRULED.

Stroup contends that the District Court improperly admitted certain alleged hearsay testimony received from Dr. Tucker and from Mueller. His constitutional claim is without merit and the Court of Appeals properly disposed of the purported error under the traditional rules of evidence.

Dr. Tucker's testimony concerned a conversation between Mueller and him, where Mueller advised Tucker that he could arrange a loan for him to finance his investment in the Riviera project and had arranged a number of loans for other physicians at the Michigan Avenue Bank. (Tr. 126-27) Stroup objected to this testimony on the grounds of hearsay.

Dr. Tucker's testimony was not hearsay, but involved a conversation in which he was a participant and had direct knowledge. It was not offered to prove the truth of the matter asserted, but to show the inducements made to investors. Moreover, to the extent that Stroup's objection was based on the notion that conversation took place after he "got out" of the conspiracy, he is plainly wrong. The conversation took place on December 8, 1971, when Dr. Tucker was at Financial Profiles to sign the Gallery Limited Partnership Agreement. (Tr. 124, 126) Thus, the Court of Appeals correctly held the evidence admissible under Rule 801(c) or (d) (2) of the Federal Rules of Evidence.

The testimony of Mueller which is singled out by Stroup as an error involves the issuance by Financial

Profiles of the dividend checks to investors with the Gallery Limited Partnership. (Tr. 259-60) Stroup, however, did not make a hearsay objection to this testimony. Indeed the only objection raised was when Mueller started to preface one of his answers with the phrase "as I assume". Stroup's objection to this answer was sustained and the question was rephrased and Mueller testified as to the transaction without objection of Storup.

It is clear that Stroup is now attempting to couple a belated objection to this evidence with his claim that he withdrew from the conspiracy. Stroup's failure to establish his withdrawal from the conspiracy, of course, has been discussed above. It should be added, however, that the jury was properly instructed both on the necessity of plaintiffs' establishing a common scheme or plan among the defendants and the circumstances under which it could properly consider the acts and declarations of alleged co-conspirators. (C. 1383-86; Tr. 473-76)

IV.

THERE WAS SUFFICIENT EVIDENCE TO SUPPORT THE JURY'S AWARD OF DAMAGES.

Stroup burdens this Court with the specious contention that there was no evidence of plaintiffs' damages.

Evidence was introduced as to the amount of both plaintiffs' investments in each of the projects. Stroup never challenged the amount of these involvements. Tucker testified, moreover, that each of the projects is now defunct and the investments worthless. (Tr. 139) Furthermore, Tucker testified that none of the monies he had invested had been returned to him; the money was lost. (Tr. 153-55)

Plaintiffs also attempted to introduce documents establishing that the projects were worthless. Stroup's ob-

jection to these exhibits were sustained, however, on the grounds the evidence was cumulative. (Tr. 194-86) In ruling on the objection, the court specifically inquired as to whether evidence had been introduced that each of the investments was worthless and in response Stroup's counsel conceded that plaintiffs "received nothing back." (Tr. 185) Subsequently, Stroup, in fact, introduced no evidence to show the investments had any value.

In essence, therefore, no real issue existed at trial as to the amounts of plaintiffs' investment, the fact plaintiffs received nothing back, nor the worthlessness of the projects. (Tr. 147-48) Nevertheless, the jury was instructed that plaintiffs were required to prove damages to sustain their Rule 10b-5 claim (C. 1359; Tr. 453-57), that the plaintiffs' damages were limited to their out-of-pocket losses, (C. 1390; Tr. 477-78) the plaintiffs were required to prove by a fair preponderance of the evidence that they suffered damages as a proximate cause of the alleged fraud (C. 1391; Tr. 478) and that they were required to prove damages to a reasonable certainty. (C. 1392; Tr. 478-79) The jury found for plaintiffs on these issues in the affirmative, on essentially an undisputed record.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that this petition for Writ of Certiorari should be denied.

Respectfully submitted,

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